AUTHOR NAME:

Dr. T. SANGEETHA, Assistant Professor, PG & RESEARCH DEPARTMENT OF COMMERCE,

JAMAL MOHAMED COLLEGE (AUTONOMOUS), TRICHY-20.

UNIT-IV
NATIONAL INCOME

What is National Income?

National Income of any country means the complete value of the goods and services produced by any country during its financial year. It is thus the consequence of all economic activities that are running in any country during the period of one year. It is valued in terms of money. In short one can say that the national income of any country is the total amount of income that is accrued by it through various economic activities in one year. It is also helpful in determining the progress of the country.

It includes wages, interest, rent, profit, received by factors of production like labour, capital, land and entrepreneurship of a nation.

National Income: Concept

There are various concepts of National Income including GDP, GNP, NNP, NI, PI, DI, and PCI which explain the facts of economic activities.

a. GDP at market price: Is money value of all goods and services produced within the domestic domain with the available resources during a year.

GDP = (P*Q)

Where,

GDP = gross domestic product

P = Price of goods and services

Q= Quantity of goods and services

GDP is made up of 4 Components

a. consumption
b. investment
c. government expenditure
d. net foreign exports of a country

b.GDP = C+I+G+(X-M)

Where,

C=Consumption

I=Investment

G=Government expenditure

(X-M) =Export minus import

Gross National Product (GNP): Is market value of final goods and services produced in a year by the residents of the country within the domestic territory as well as abroad. GNP is the value of goods and services that the country's citizens produce regardless of their location.

GNP=GDP+NFIA or,

GNP=C+I+G+(X-M) +NFIA

Where,
C=Consumption

I=Investment
G=Government expenditure
(X-M) =Export minus import
NFIA= Net factor income from abroad.

c. Net National Product (NNP) at MP: Is market value of net output of final goods and services produced by an economy during a year and net factor income from abroad.
NNP=GNP-Depreciation
or, **NNP=C+I+G+(X-M) +NFIA- IT-Depreciation**
Where,
C=Consumption
I=Investment

G=Government expenditure
(X-M) =Export minus import
NFIA= Net factor income from abroad.

IT= Indirect Taxes

d. National Income (NI): Is also known as National Income at factor cost which means total income earned by resources for their contribution of land, labour, capital and organisational ability. Hence, the sum of the income received by factors of production in the form of rent, wages, interest and profit is called National Income.

Symbolically or as per the formula
NI=NNP +Subsidies-Interest Taxes
or, GNP-Depreciation +Subsidies-Indirect Taxes
or, NI=C+G+I+(X-M) +NFIA-Depreciation-Indirect Taxes +Subsidies

e. Personal Income (PI): Is the total money income received by individuals and households of a country from all possible sources before direct taxes. Therefore, personal income can be expressed as follows:
PI=NI-Corporate Income Taxes-Undistributed Corporate Profits- Social Security Contribution +Transfer Payments.
f. Disposable Income (DI) : It is the income left with the individuals after the payment of direct taxes from personal income. It is the actual income left for disposal or that can be spent for consumption by individuals.
Thus, it can be expressed as:

DI=PI-Direct Taxes
g. Per Capita Income (PCI): It is calculated by dividing the national income of the country by the total population of a country.
Thus, **PCI=Total National Income/Total National Population**
Measurement of National Income
There are three methods to calculate National Income:

1. Income Method

2. Product/ Value Added Method
3. Expenditure Method

- **Income Method**

  In this National Income is measured as flow of income.

  We can calculate NI as:

  Net National Income = Compensation of Employees+ Operating surplus mixed (w +R +P +I) + Net income + Net factor income from abroad.

  Where,

  W = Wages and salaries

  R = Rental Income

  P = Profit

  I = Mixed Income

- **Product/ Value Added Method**

  In this National Income is measured as flow of goods and services.

  We can calculate NI as:

  NATIONAL INCOME = G.N.P – COST OF CAPITAL – DEPRECIATION – INDIRECT TAXES

- **Expenditure Method**

  In this National Income is measured as flow of expenditure.

  We can calculate NI through Expenditure method as:

  National Income=National Product=National Expenditure.

Inflation

What is Inflation?

In economics, inflation (or less frequently, price inflation) is a general rise in the price level of an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services; consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy.

Causes / Types of Inflation

The different types of inflation in an economy can be explained as follows:

Demand-Pull Inflation

This type of inflation is caused due to an increase in aggregate demand in the economy.

Causes of Demand-Pull Inflation:

- A growing economy or increase in the supply of money – When consumers feel confident, they spend more and take on more debt. This leads to a steady increase in demand, which means higher prices.
- Asset inflation or Increase in Forex reserves– A sudden rise in exports forces a depreciation of the currencies involved.
- Government spending or Deficit financing by the government – When the government spends more freely, prices go up.
- Due to fiscal stimulus.
- Increased borrowing.
- Depreciation of rupee.
- Low unemployment rate.

Effects of Demand-Pull Inflation:

- Shortage in supply
- Increase in the prices of the goods (inflation).
- The overall increase in the cost of living.

Cost-Push Inflation

This type of inflation is caused due to various reasons such as:

- Increase in price of inputs
- Hoarding and Speculation of commodities
- Defective Supply chain
- Increase in indirect taxes
- Depreciation of Currency
- Crude oil price fluctuation
- Defective food supply chain
- Low growth of Agricultural sector
- Food Inflation
- Interest rates increased by RBI

Cost pull inflation is considered bad among the two types of inflation. Because the National Income is reduced along with the reduction in supply in the Cost-push type of inflation.

Built-in Inflation

This type of inflation involves a high demand for wages by the workers which the firms address by increasing the cost of goods and services for the customers.

Remedies to Inflation

The different remedies to solve issues related to inflation can be stated as:

- **Monetary Policy (Contractionary policy)**

The monetary policy of the Reserve Bank of India is aimed at managing the quantity of money in order to meet the requirements of different sectors of the economy and to boost economic growth.

This contractionary policy is manifested by decreasing bond prices and increasing interest rates. This helps in reducing expenses during inflation which ultimately helps halt economic growth and, in turn, the rate of inflation.

- **Fiscal Policy**
  - Monetary policy is often seen separate from fiscal policy which deals with taxation, spending by government and borrowing. Monetary policy is either contractionary or expansionary.
  - When the total money supply is increased rapidly than normal, it is called an expansionary policy while a slower increase or even a decrease of the same refers to a contractionary policy.
  - It deals with the Revenue and Expenditure policy of the government.

Tools of fiscal policy

1. Direct Taxes and Indirect taxes – Direct taxes should be increased and indirect taxes should be reduced.
2. Public Expenditure should be decreased (should borrow less from RBI and more from other financial institutions)

- **Supply Management measures**
  - Import commodities that are in short supply
  - Decrease exports
  - Govt may put a check on hoarding and speculation
  - Distribution through Public Distribution System (PDS).

Measurement of Inflation

1. Wholesale Price Index (WPI) – It is estimated by the Ministry of Commerce & Industry and measured on a monthly basis.
2. Consumer Price Index (CPI) – It is calculated by taking price changes for each item in the predetermined lot of goods and averaging them.
3. Producer Price Index – It is a measure of the average change in the selling prices over time received by domestic producers for their output.
4. Commodity Price Indices – It is a fixed-weight index or (weighted) average of selected commodity prices, which may be based on spot or futures price

5. Core Price Index – It measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices. It is a way to measure the underlying inflation trends.
6. GDP deflator – It is a measure of general price inflation.

Effect of Inflation on the Economy

The effect of inflation on the economy can be stated as:

- The effect of inflation is not distributed evenly in the economy. There are chances of hidden costs for different goods and services in the economy.
- Sudden or unpredictable inflation rates are harmful to an overall economy. They lead to market instability and thereby make it difficult for companies to plan a budget for the long-term.
- Inflation can act as a drag on productivity as companies are forced to mobilize resources away from products and services to handle the situations of profit and losses from inflation.
- Moderate inflation enables labour markets to reach equilibrium at a faster pace.