

# Lesson – 24

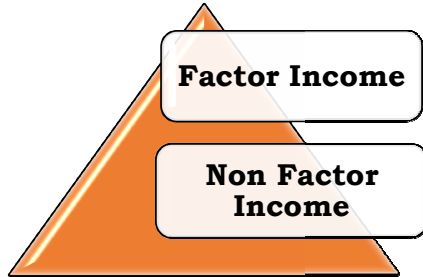
## National Income and Related Aggregates

### Summary

The main objective of an economy is to provide goods and services for the satisfaction of different types of wants of the people. This objective is achieved through production process. During production process, income is generated in the economy. Most of you must have heard or read about national income. It consists of two words national and income. Each of these words has specific meaning in economics. In this lesson, you will learn about the meaning of income, national income, and some basic concepts of national income. Without knowing these concepts it is very difficult to understand the meaning and the ways of measuring national income

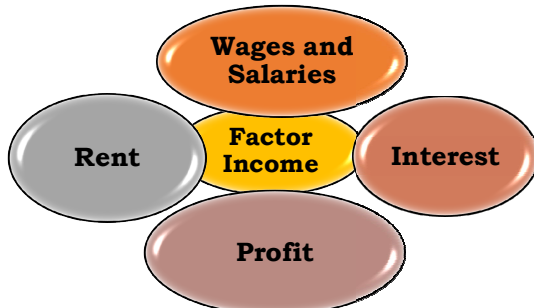
### Meaning of Income

Income includes both factor income and non factor income



#### **Factor Income -**

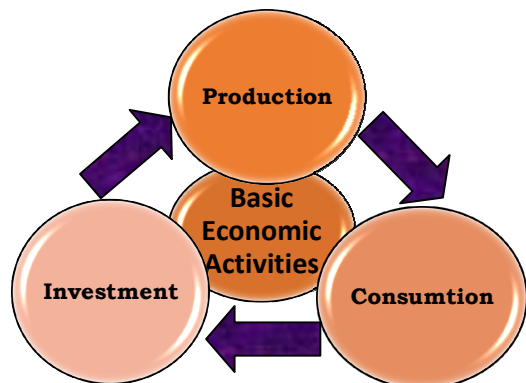
Income received by factors of production is known as factor income i.e. in the form of rent, wages & salaries, interest and profit.



#### **Non Factor Income –**

It includes gifts, donation charities, taxes, fines etc. No production activity is involved in getting these incomes. These income are called transfer incomes because such income merely represent transfer of money without any good or service being provided in return for the receipts.

### Basic Economic Activities



Production, consumption and investment are continuous activities of an economy.

## **Closed Economy and Open Economy**

### **Closed Economy**

The closed economy is the term used for a country which has no economic relations with the rest of the world.

### **Open Economy**

Open economy are those economy which are having economic relation with rest of the world.

## **Stock and Flow**

### **Stock**

A stock is a quantity which is measured at point of time i.e. at 4 p.m. on 31st March etc. wealth, population, money supply etc. are stock concepts. It has no time dimension.

### **Flow**

A flow is a quantity which is measured over a period of time i.e. days, month, years etc. It has time dimension. National income, population growth are flow concepts.

## **Circular Flow of Income**

Production, consumption and investment are important economic activities of an economy. In carrying out these economic activities, people make transactions between different sectors of the economy. Because of these transactions, income and expenditure move in circular form. This is called circular flow of income.

In this way, the flow of goods and services (real flow) and flow of money payments (money flow) together make a circular flow.

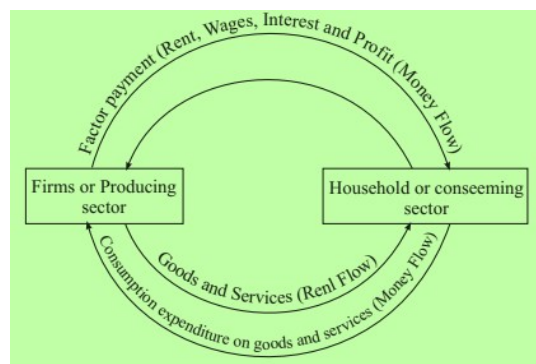
### **Real flow**

Flow of factor services from households to firms and flow of goods and services from firms to households is known as real flow.

### **Money flow**

Households receive rent for land, wages for labour, interest for capital and profit for entrepreneurship from firms and make payment for goods and services supplied by firms. This flow of money between firms and households is called money flow.

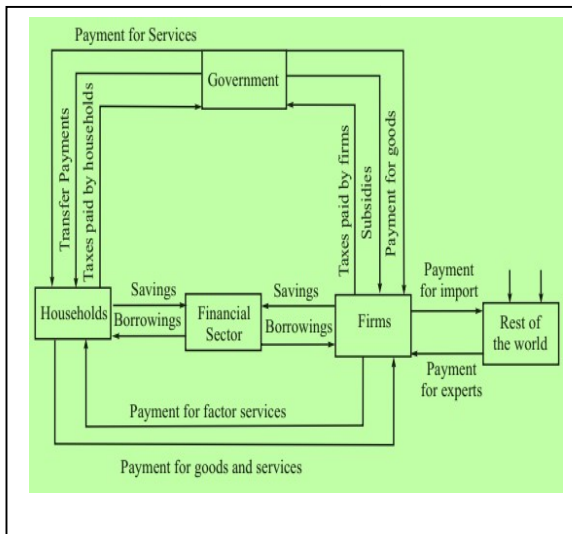
### **Circular flow of income in a two sector economy without saving**



Different sectors of the economy and their inflows and outflows. An open economy can be divided into following five sectors:

- Producing sector
- Household sector
- Government sector
- Financial sector
- Rest of the world sector.

This can be shown with diagram.



Value of output = Sales + change in Stock

**Value Added**

After deducting value of intermediate goods from value of output we get value added.

Value Added = Value of output – Intermediate Consumption

Net Value of output = Gross Value of output – depreciation

Net Value of added = Gross Value of added – Depreciation

**Intermediate Goods and Final Goods**

**Intermediate Goods**

- Intermediate goods are those goods which are meant either for reprocessing or for resale.
- Intermediate goods are not included in the calculation of national income

**Final Goods**

- Goods which are used either for final consumption by the consumers or for investment by the producers are known as final goods.
- final goods are included in the calculation of national income.

**Market Price and Factor cost**

**Net Indirect Taxes**

It is the difference between indirect tax and subsidy.

Net Indirect Tax = Indirect Tax – Subsidy

Market Price = Factor cost+ Net Indirect Tax

Factor cost = Market Price – Net Indirect Tax

**Value of Output and Value Added**

**Value of Output**

Money value of all goods and services produced is known as value of output.

Value of output = Quantity × Price

**Domestic Income vs National Income**

National Income = Domestic Income + Factor income received from ROW – Factor payments made to ROW

Net Factor Income from ROW- It is the difference between factor income 's received from ROW and factor payments made to ROW.

National Income/Product = Domestic Income/product + Net factor income from abroad

### **Nominal and Real GDP**

- When the money value of goods and services included in GDP is estimated on the prices of current year, it is called GDP at current prices or nominal GDP.
- On the other hand, when the value of goods and services included in GDP is estimated on the prices of base year, we get GDP at constant prices or real GDP

### **National Income as Aggregate of Factor income**

National Income as aggregate of factor incomes-

- National Income = Compensation of employees + Rent + Interest + profit + Mixed income + Net factor income from ROW.  
Or
- National Income = NDP at FC + Net Factor income from ROW.
- It is Net National Product at factor cost which is called National Income of a country.

### **National Income and aggregate of Final Expenditure**

The final expenditure is classified into-

- (a) Private final consumption expenditure
- (b) Government final consumption expenditure

(c) Investment Expenditure/Gross Domestic Capital Formation

(d) Net exports

Gross Domestic Product at Market Price = Private final consumption expenditure + Government Final Consumption Expenditure + Gross Domestic Capital Formation (Gross Domestic Fixed Capital Formation + Change in Stock) + Net Export.

### **National Income and its Related Aggregates**

#### **Gross Domestic Product at Market Price**

It is the money value of all the final goods and services produced within the domestic territory of a country during an accounting year.

GDPMP = Net domestic product at FC (NDPFC) + Depreciation + Net Indirect tax.

#### **Gross Domestic Product at FC**

It is the value of all final goods and services produced within domestic territory of a country which does not include net indirect tax.

GDPFC = GDPMP – Indirect tax + Subsidy

Or

GDPFC = GDPMP – NIT

#### **Net Domestic Product at Market Price**

It is the money value of all final goods and services produced within domestic territory of a country –  
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during an accounting year and does not include depreciation.  $NDPMP = GDPMP - \text{Depreciation}$

### **Net Domestic Product at FC**

It is the value of all final goods and services which does not include depreciation charges and net indirect tax. Thus it is equal to the sum of all factor incomes (compensation of employees, rent, interest, profit and mixed income of self employed) generated in the domestic territory of the country.

$NDPFC = GDP \text{ at MP} - \text{Depreciation} - \text{Indirect tax} + \text{Subsidy}$

### **Net National Product at FC (National Income)**

It is the sum total of factor incomes (compensation of employees + rent + interest + profit) earned by normal residents of a country in an accounting year.

$NNPFC = NDPFC + \text{Factor income earned by normal residents from ROW} - \text{factor payments made to ROW}$

### **Gross National Product at FC**

It is the sum total of factor incomes earned by normal residents of a country along with depreciation, during an accounting year.

$GNPFC = NNPFC + \text{Depreciation}$

### **Net National Product at MP**

It is the sum total of factor incomes earned by the normal residents of a country during an accounting year including net indirect taxes.

$NNP \text{ MP} = NNPFC + \text{Indirect tax} - \text{Subsidy}$

### **Gross National Product at MP**

It is the sum total of factor incomes earned by normal residents of a country during an accounting year including depreciation and net indirect taxes.

$GNPMP = NNPFC + \text{Depreciation} + \text{NIT}$

### **Domestic Territory**

Domestic territory of a country includes the following-

- Political frontiers of the country including its territorial waters.
- Ships, and aircrafts operated by the normal residents of the country between two or more countries.
- Fishing vessels, oil and natural gas rigs and floating platforms operated by the residents of the country in the international waters
- Embassies, consulates and military establishments of the country located in other countries, for example, Indian embassy in U.S.A., Japan etc.

### **Normal Resident**

The term normal resident is different from the term nationals (citizens). A normal resident is a person who ordinarily resides in a country and whose centre of economic interest also lies in that particular country. Normal residents include both nationals (such as Indians living in India) and foreigners (non-nationals living in India).

### **Evaluate Yourself**

Q. Distinguish between final goods and intermediate goods with suitable example.

Q. Calculate GDP at mp, GNP at fc and NNP at fc on the basis of given concepts –NNP at fc, Depreciation, NFIA, and and NIT.

Q. List out the types of final expenditure which provides the basis of estimating national income.

Q. Explain the circular flows of income in a two sector economy