Welcome

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National Income

- Topic covered
- **Methods of Measurement of National Income**

2) Income Method : This method of measuring national income is also known as factor cost method. This method estimates national income from the distribution side. According to this method, the income payments received by all citizens of a country, in a particular year, are added up, that is, incomes that accrue to all factors of production by way of rents, wages, interest and profits are all added together, but income received in the form of transfer payments are ignored.

The data pertaining to income are obtained from different sources, for instance, from income tax returns, reports, books of accounts, as well as estimates for small income.

GNP can be treated as the sum of factor incomes, earned as a result of undertaking economic activity, on the part of resource owners and reflected in the production of the total output of goods and services during any given time period. Thus, GNP, according to income method, is calculated as follows:

NI = Rent + Wages + Interest + Profit + Mixed Income + Net income from abroad.

NI = R + W + I + P + MI + (X–M)

- Precautions :
- While estimating national income by income method, the following precautions should be taken.

1) Transfer incomes or transfer payments like scholarships, gifts, donations, charity, old age pensions, unemployment allowance etc., should be ignored.

2) All unpaid services like services of a housewife, teacher teaching her/his child, should be ignored.

3) Any income from sale of second hand goods like car, house etc., should be ignored.

4) Income from sale of shares and bonds should be ignored, as they do not add anything to the real national income.

5) Revenue received by the government through direct taxes, should be ignored, as it is only a transfer of income.

6) Undistributed profits of companies, income from government property and profits from public enterprise, such as water supply, should be included.

7) Imputed value of production kept for self- consumption and imputed rent of owner occupied houses should be included. In India, the National Income Committee of the Central Statistical Organization, uses the income method for adding up the income arising from trade, transport, professional and liberal arts, public administration and domestic services.

2) Expenditure Method

This method of measuring national income is also known as Outlay Method.

According to this method, the total expenditure incurred by the society, in a particular year, is added together. Income can be spent either on consumer goods or on capital goods. Thus, we can get national income by summing up all consumption expenditure and investment expenditure made by all individuals, firms as well as the government of a country during a year.

Thus, gross national product is found by adding up

NI = C + I + G + (X–M) + (R–P)

1) Private Final Consumption Expenditure (C) :

Private Final Consumption Expenditure (C) by households on non-durable goods, such as food, which are used immediately; expenditure on durable goods such as car, computer, television set, washing machine etc., which are generally used for a longer period of time; and expenditure on services like transport services, medical services, etc.

2) Gross Domestic Private Investment Expenditure (I) : It refers to expenditure made by private businesses on replacement, renewals and new investment (I).

3) Government Final Consumption and Investment Expenditure (G)

1) Government's final consumption expenditure refers to the expenditure incurred by government on various administrative services like, law and order, defense, education, health etc.

2) Government's investment expenditure refers to the expenditure incurred by government, on creating infrastructural facilities like construction of roads, railways, bridges, dams, canals, which are used by the business sector for production of goods and services in any economy (G).

4) Net Foreign Investment/Net Exports : It refers to the difference between exports and imports of a country during a period of one year.

5) Net Receipts (R-P) : The difference between expenditure incurred by foreigners on domestic goods and services (R) and expenditure incurred abroad by residents on foreign goods and services (P).

- **Precautions**
- While estimating national income by Expenditure Method, the following precautions should be taken.

1) Expenditure on all intermediate goods and services should be ignored, in order to avoid double counting.

2) Expenditure on the repurchase of second hand goods, should be ignored, as it is not incurred on currently produced goods.

3) Expenditure on transfer payments like scholarships, old age pensions, unemployment allowance etc., should be ignored.

4) Expenditure on repurchase of financial assets such as shares, bonds, debentures etc., should not be included, as such transactions do not add to the flow of goods and services.

5) Indirect taxes should be deducted.

6) Expenditure on final goods and services should be included.

7) Subsidies should be included.

Out of these methods, the Output Method and Income Method are extensively used. In advanced countries like U.S.A. and U.K. the Income Method is popular. Expenditure Method is rarely used by any country because of practical difficulties. In India, the Central Statistical Organization (CSO) adopts a combination of both output method and income method to estimate national income of India.

THANKS