

CHAPTER 2

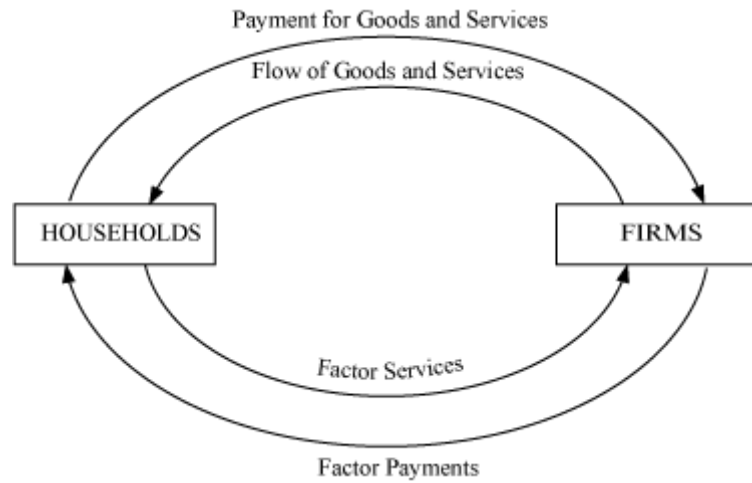
NATIONAL INCOME ACCOUNTING

- **Final goods** are those goods which are ready for use for final consumption. For example wheat purchased for self consumption.
- **Intermediate goods** are those goods which are used for further production or for the purpose of resale during a year for example, wheat purchased by flour industry.

NOTE: If wheat is purchased by a household, then it is considered as a final good, as it is meant for final consumption. But if wheat is purchased by a flour industry for further processing, then it is considered as an intermediate good.

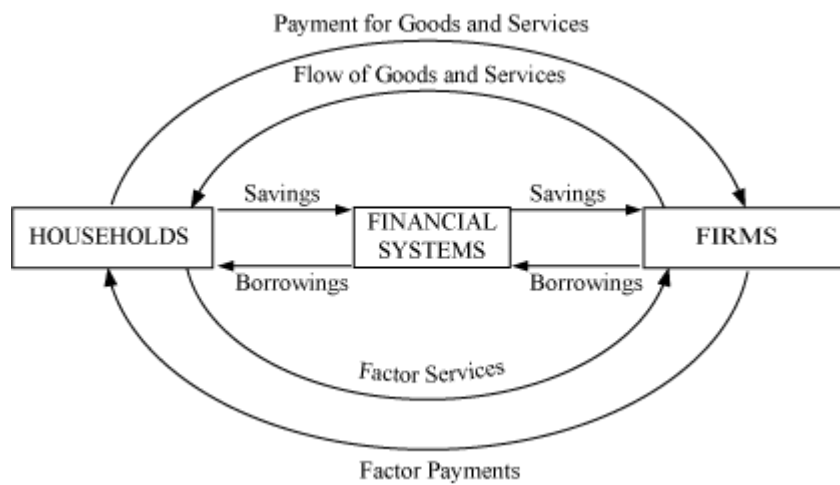
- **Consumer goods (Consumption goods)** are those goods which are bought by consumers for satisfaction of their wants. For example, vegetables used by households.
- **Capital goods** are those goods which are used for the production process several times, and add to the productive capacity and to the capital stock of the country. For example, plant and machinery
- The stock of unsold goods (finished and unfinished), which a firm carries forward from one year to another year, is termed as **inventory**.
- **The planned inventory** refers to the expected inventory that a firm can anticipate or plan.
- **Unplanned inventory** is the unexpected or unanticipated rise in inventory.
- **Stock variables** are measured at a particular point of time. For example, bank balance as on 1st Oct, 2011 is Rs,5000.
- **Flow variables** are measured over an interval of time. For example, interest earned on bank deposits for 1 year, i.e., from 1st Oct, 2010 to 1st Oct, 2011.
- **Circular flow of income in a two sector economy**

This model of the economy involves two sectors namely, households and firms. This model depicts the activities of the above two sectors.



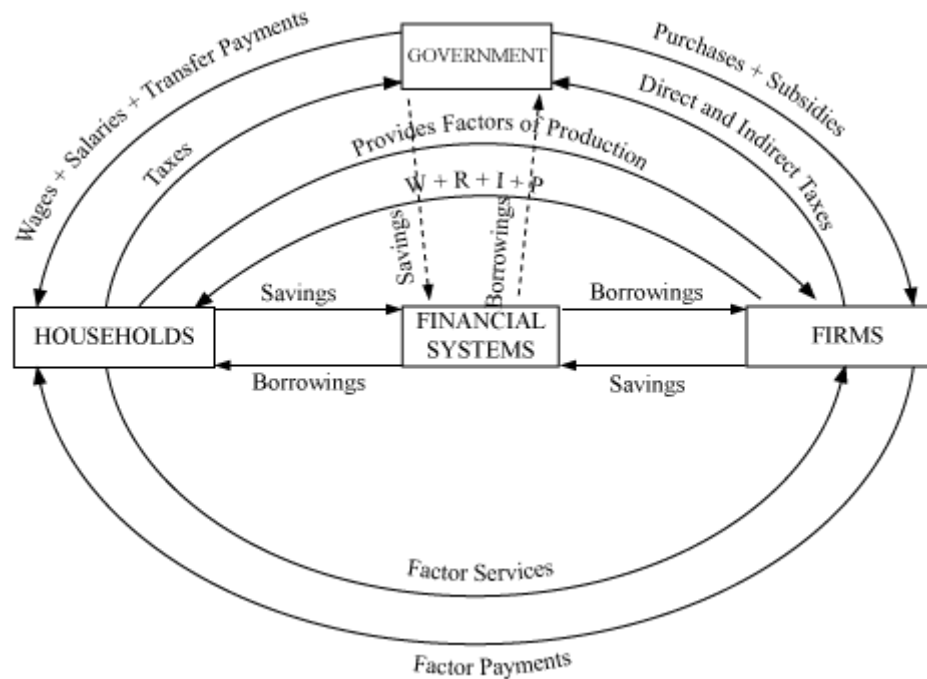
➤ **Circular flow of income in a two sector economy with financial system.**

The particular model of the economy comprises two sectors namely households and firms with the involvement of financial system like banks.



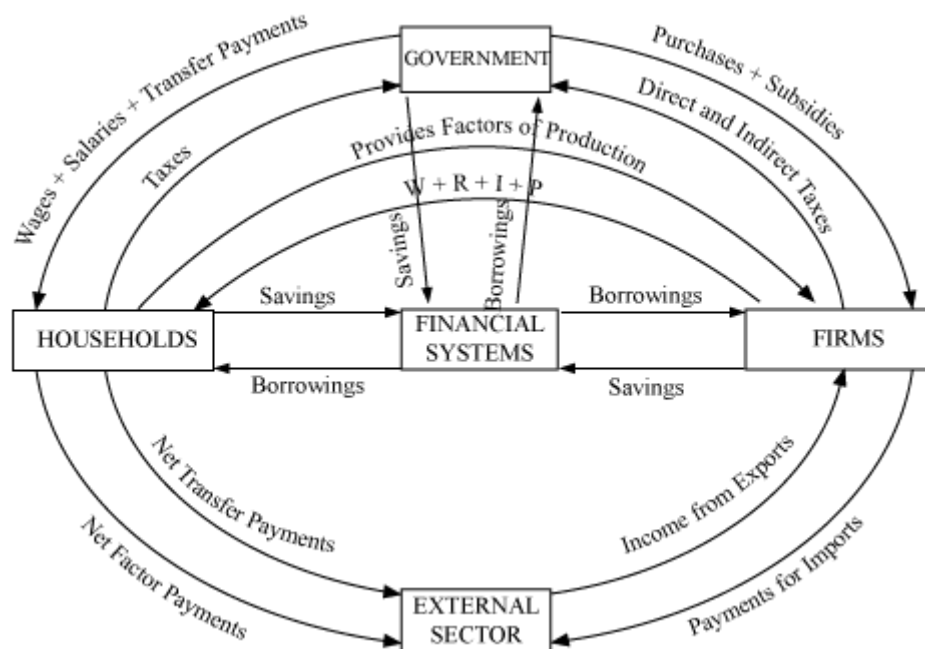
➤ **Circular flow of income in a three sector economy**

The three sector model shows the activities of three sectors: households, firms, government, with the involvement of financial system.



➤ **Circular flow of income in a four sector economy**

This model operates in the open market, where exports and imports with rest of the world take place with the functioning of the three sectors (with the involvement of financial system).



- **Injections** are those flow variables which cause addition to the circular flow of income.

These are:

- Exports
- Investments
- Consumption expenditures

- **Leakages** are those flow variables which cause withdrawals from the circular flow of income. These are:

- Savings
- Imports
- Taxes imposed by the government

- For maintaining stability in the economy (at equilibrium)

Injections = Leakages

- **Net factor income from abroad (NFIA)** is the difference between the income received from abroad by the residents of the country and income paid for the services rendered by non-residents within the country.

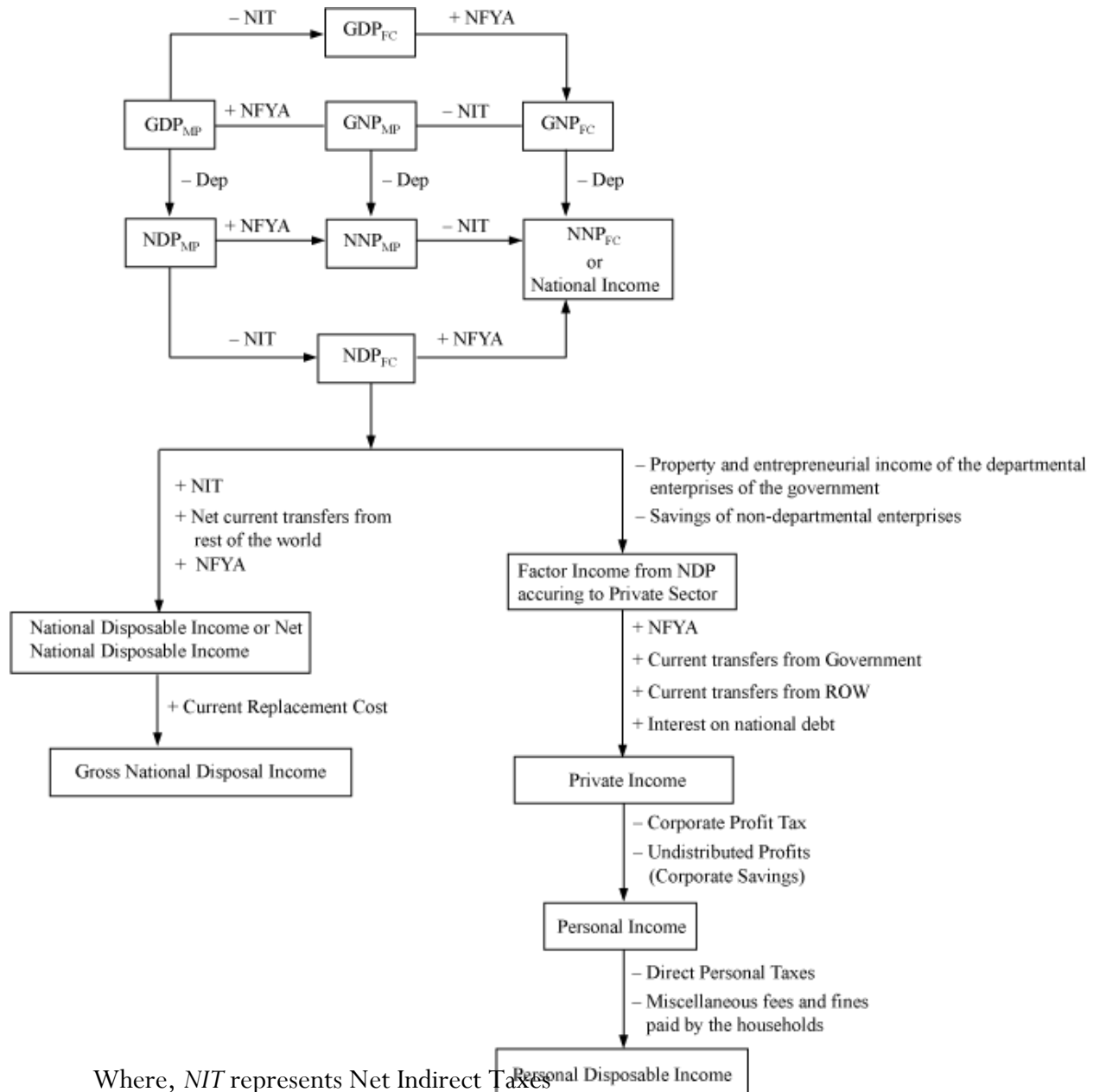
- **Components of NFIA**

- Net compensation of employees
- Net income from property and entrepreneurship
- Net retained earnings of resident companies abroad

- **Important Formulae:**

- $\text{Gross} = \text{Net} + \text{Depreciation}$
or $\text{Net} = \text{Gross} - \text{Depreciation}$
- $\text{National} = \text{Domestic} + \text{Net factor income from abroad}$
- $\text{Domestic} = \text{National} - \text{Net factor income from abroad}$
- $\text{Market price} = \text{Factor cost} + \text{Net indirect taxes}$
- $\text{Factor cost} = \text{Market price} - \text{Net indirect taxes}$
- $\text{Net indirect taxes} = \text{Indirect taxes} - \text{Subsidies}$

- **National income** is defined as the value of all goods and services produced within the domestic territory of a country in an accounting year.
- **GDP (Gross domestic product) at market price** is defined as the market value of final goods and services produced in the domestic territory of a country during a year.



Where, *NIT* represents Net Indirect Taxes

NFYA represents Net Factor Income from Abroad

Dep. represents Depreciation

MP represents Market Price

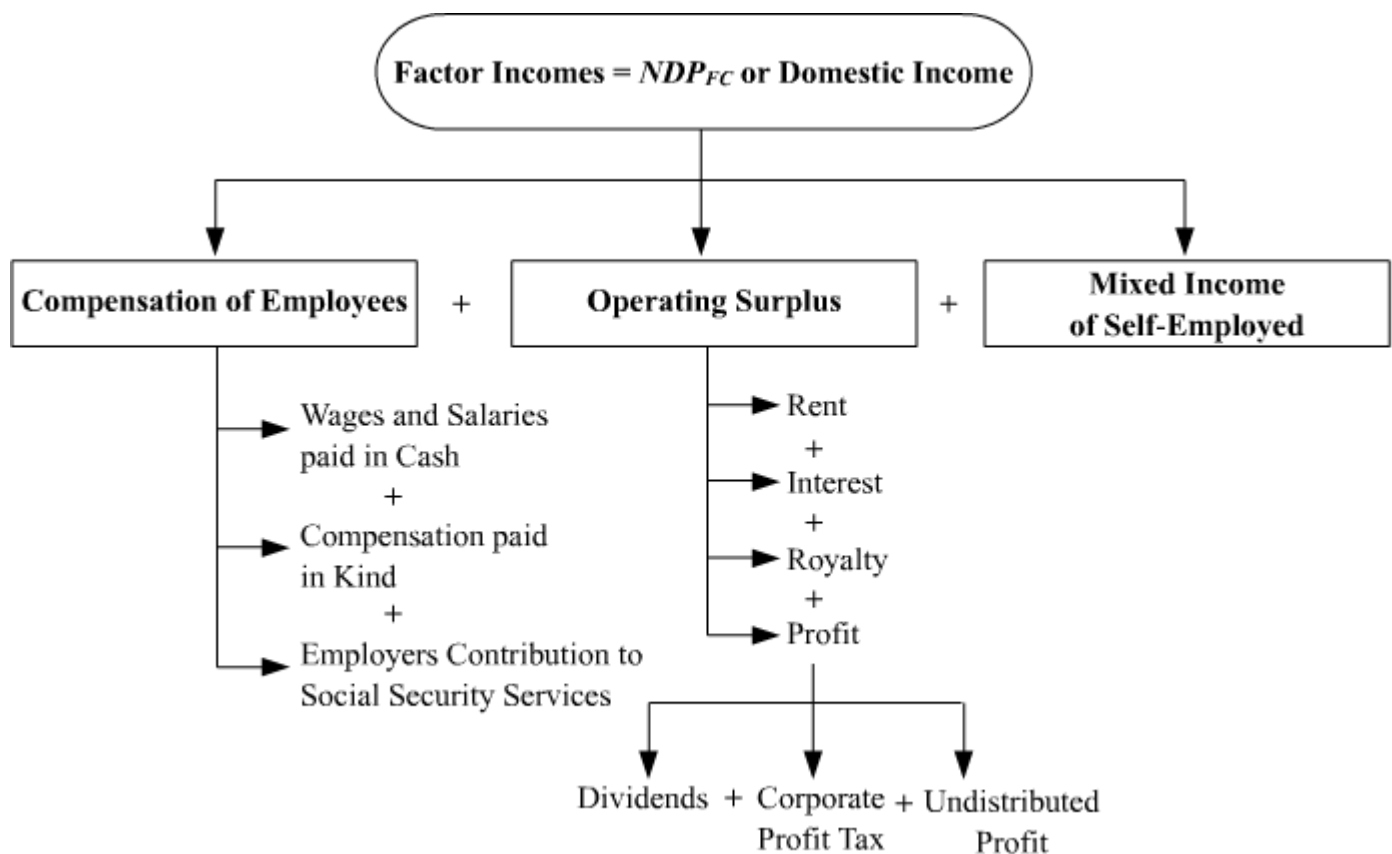
FC represents Factor Cost

NDP represents Net Domestic Product

NNP represents Net National Product

➤ **Methods to Compute National Income**

- **Income Method**



- **Value Added or Product Method**

Value added = Total value of output – Total value of intermediate consumption.

Total value of output = Quantity sold $\times$ Price per unit

However, sometimes the actual demand might not be equal to what the firms had estimated (planned)

In such situations the stock of inventories changes

Change in Stock = Closing Stock – Opening Stock

Total value of output = Value of sales + Value of change in stock

$$GVA_1 + GVA_2 + \dots + GVA_n$$

where,

GVA_1 represents gross value added by 1st firm

GVA_2 represents gross value added by 2nd firm

GVA_n represents gross value added by n^{th} firm

$$\sum_{i=1}^n GVA_i = GDP_{MP}$$

$$GDP_{MP} \xrightarrow{(-)} \text{Depreciation} \rightarrow NDP_{MP} \xrightarrow{(-)} \text{Net Indirect Taxes} \rightarrow NDP_{FC} \xrightarrow{(+)} NFIA \rightarrow NNP_{FC}$$

- Expenditure Method or Final Consumption Method

