Methods to Calculate National Income

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Term Assignment

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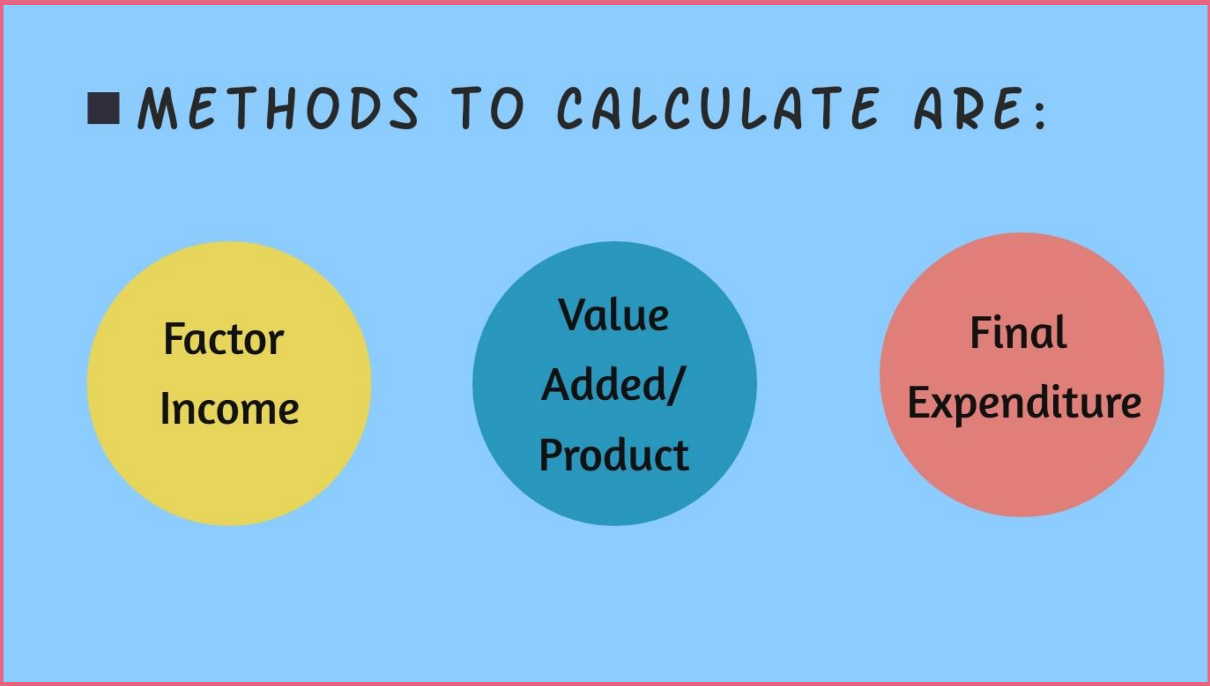
CSE-D



- National Income in India is **calculated by using combined method**. This is a combination of two methods- **product/output method and income method.**

Some Basic Terms:

1. **GDP** – It measures the total value of national output of goods and service provided in a given time.

2. **NDP** – It is the money value of all final goods and services produced within the country after providing for depreciation.

3. **NNP** – It is the money value of all final goods and services of a country after providing for depreciation.

4. **GNP** – It is total money value of all final goods and services produced annually in a country plus net factor income from abroad.

5. **NFIA** - Factor income received from Abroad – Factor income paid to Abroad.

Reports of Last 5 Years:

Income Method:

It is also known as Factor Payment Method.

It is termed basically on the basis of supplier and owner of Factors of Production.

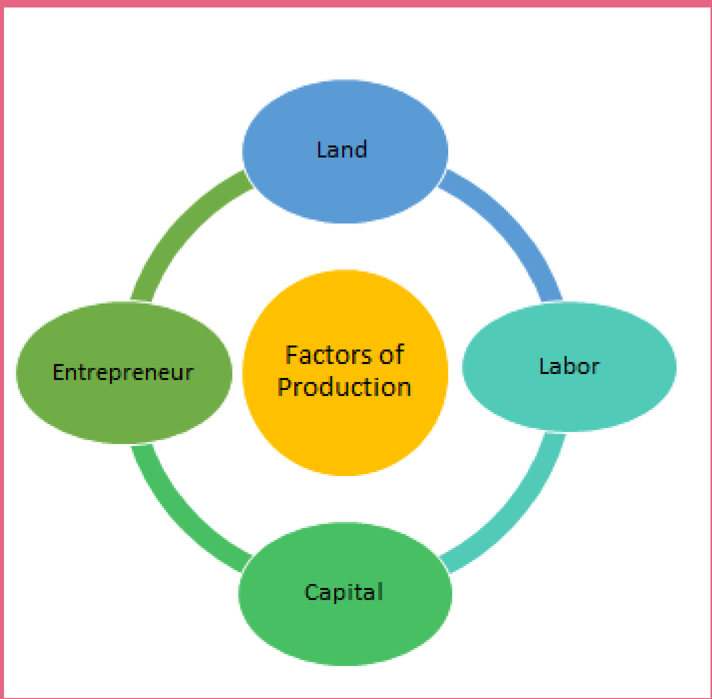
- It measures national income by the side of payments made to the factors of production in form of wages, rent, interest and profit for their services during an accounting year.

❖ It is calculated within the domestic economy during an accounting period.

Primary Objective:

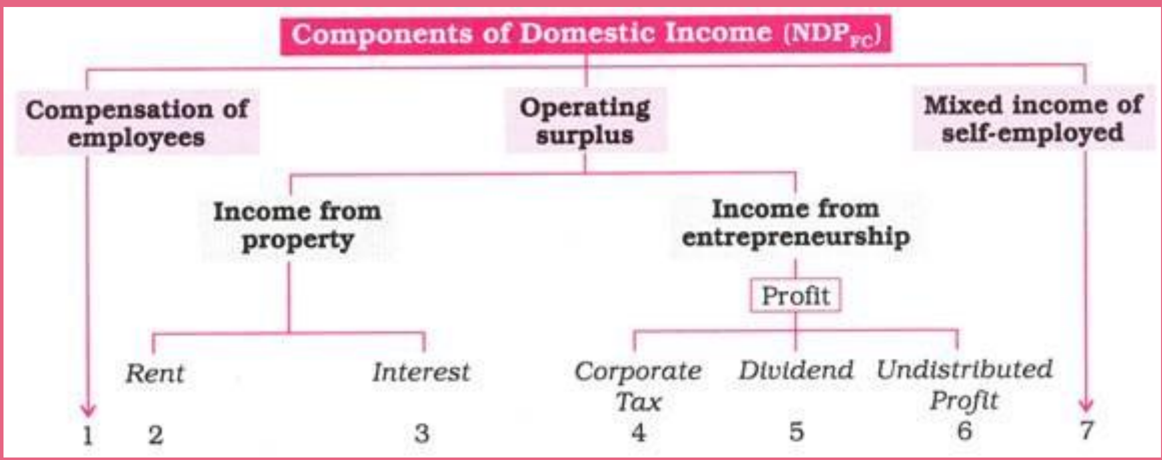
It is measured at the stage when incomes are paid out by enterprises to the owners of factors of production.

It measures based on the flow of factor revenues.



Steps to be followed:

- Initially divide or segregate the production units on the basis of
    i. Primary Sector
    ii. Secondary Sector
    iii. Tertiary Sector



- On the basis of factor payments to the factors of production that are:
    - Salaries/Wages/Social Security
    - Rent-Royalties-Interest
    - Divided Undistributed Profit
    - Mixed Income

- Compensation to employees.

- ❖ Sum up all the listed and if not some of them are not present take it as '0'.
- ❖ Rent-Interest-Profit together is called **Operating Surplus**.
- ❖ Similarly, "**Compensation to Employees**" include wages in Kind and Cash.

- By summing up in the previous step you will end up with the NDP(FC). Thus, by finally adding NFIA to the previous one we will have our NNP(FC).

Precautions:

- Factor incomes by rendering productive services are included while excluding unemployment allowance, pension etc.
- Second-hand goods sales and purchase are excluded while commission paid to it is included.
- Value of Self-consumed services are not included.

- Lotteries, windfall gains and income by illegal activities are excluded.
- Wealth tax, gift tax excluded.
- Sales tax, excise duties are not included.

Value Added Method:

It focuses on adding value to a product at each stage of production.

It is even called a Product Method or output or inventory method.

This method denotes the value added by each and every level starting from base level that is production to the final state.

Primary Objective:

- primary objective is calculating the national income by taking into account the value added to a product during the various stages of production

Steps:

1. Calculate Gross Value added at Market Price through dividing them into:

    a. Primary Sector

    b. Secondary Sector

    c. Tertiary Sector

2. Here, **Gross value added** at Market Price **Gross Domestic Production** and Value Added are same at Market Price.

- Value of Output - Intermediate Consumption
- Where "**intermediate Consumption**" accommodates Domestic Purchase and Imports.
- Similarly, "**Value of Output**" accommodates Sales (Price x Quantity) and change in Stocks and export too.

- Here value of Output stands for market **value of goods produced by a firm during financial year.**
- Similarly, intermediate goods are non-factor in nature.
- Here **GDP(MP) = ∑ value added**
- Similarly, **NDP(MP)=∑ net value added**

3. **NNP(FC) = GDP (MP) + NFIA – depreciation – (Net Indirect Tax)**
    - Here adding NFIA changes it to GNP(MP).
    - Then subtracting depreciation turns it to NNP(MP).
    - Finally, subtracting NIT changes it to NNP(FC).

Producers	Stages of Production	Selling Price	Cost Price	Value Added
Farmers	Wheat	80	0	80
Millers	Flour	100	80	20
Baker	Bread	120	100	20
Total		300	180	120

- Value Added includes the contribution of each stage of production, hence it **eliminates the Double-counting error**.

Precautions:

- Intermediate goods should not be calculated while calculating National Income.
- Dealings of 2^{nd} hand goods should not be calculated.
- Self-consumption services should be abandoned as they are termed as non-market transaction.
- The estimated values of houses owned by individual should be calculated as they possess the mark as imputed rents.

Expenditure Method:

It is called "**INCOME DISPOSAL METHOD**".

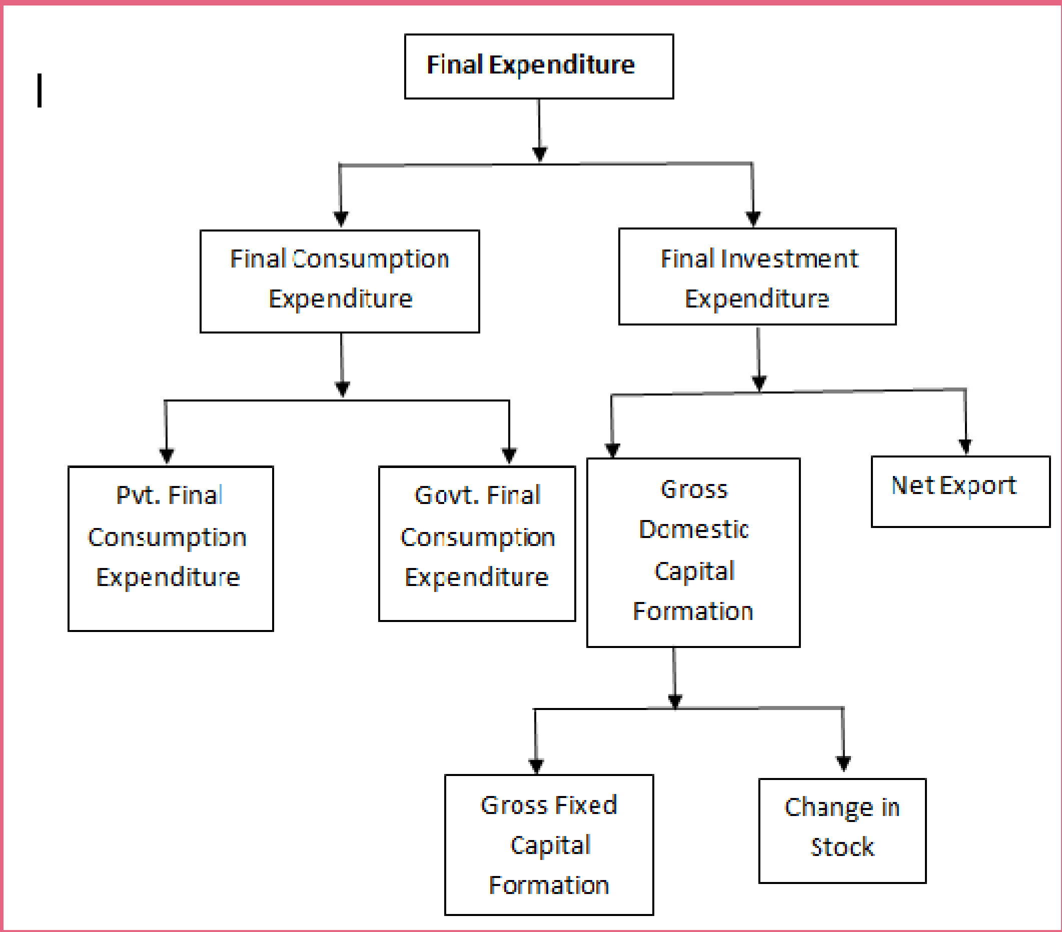
It is a method used for determining the GDP of country. This calculates the Annually produced Goods and Service Expenditure.

Primary Objective:

- It is the most common way to calculate GDP as it includes both public and private sector expenses bounded within the nation's borders.

Drawbacks:

- It can only be used to calculate nominal GDP, which is not adjusted for inflation.



Steps:

1. Here initially you have to segregate into 4 sectors i.e.
    - Household
    - Producer
    - Government
    - World

2. There are primarily 4 different types of **aggregated expenses** that are utilised to determine GDP:

    A. Gross domestic Consumption by producer

    B. Government expenses on goods and services.

    C. Final consumption expenditure of Household sector.

    D. Net Export.

3. Now, summing up all the sectors from the above state leads to GDP(MP) which equals to **Gross Domestic Expenditure**.

4. Thus, on adding NFIA leads to GNP(MP) which in turn equals to Gross National Expenditure.

5. Finally, by subtracting depreciation we get NNP(MP) and thus, **subtracting Net Indirect Tax** we get NNP(FC).

Precautions:

- Any intermediate goods cannot be considered as it leads to double counting.
- No transfer payments are included.
- Purchase of second-hand goods are not included while brokerage paid to it is included.
- Share, bonds and debentures are not included.
- While brokerage earned on trading of share is included.
- Imputed values of occupied residential units are also included.

References:

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