National Income

National Income is a measure of the money value of goods and services becoming available to a nation from economic activities.

It can also be defined as the total money value of all final goods and services produced by the nationals of a country during some specific period of time – usually a year – and to the total of all incomes earned over the same period of time by the nationals.

This refers to the measuring of the total flow of output (goods and services) and of the total flow of inputs (factors of production) that pass through all of the markets in the economy during the same period. National Income is a measure of the total flow of earning of the factor-owners through the production of goods and services. In simple words, it is the total amount of income earned by the aggregate output.

Factors Affecting National Income

4.1 Factors of production

Normally the more efficient and richer the resources, higher will be the level of National Income or GNP

4.1.1 Land

Resources like coal, iron and timber are essential for heavy industries so that they must be available and accessible. In other words, the geographical location of these natural resources affects the level of GNP.

4.1.2 Capital

Capital is generally determined by investment. Investment in turn depends on other factors like ***profitability, political stability etc.***

4.1.3 Labour and Entrepreneur

The quality or productivity of human resources is more important than quantity. ***Manpower planning and education affect the productivity and production capacity of an economy.***

4.1.4. Technology

This factor is more important for Nations with fewer natural resources. The development in technology is affected by the level of invention and **innovation in production.**

4.1.5. Government

Government can help to provide a favorable business environment for investment. It provides law and order, regulations.

4.1.6 Political Stability

A stable economy and political system helps in appropriate allocation of resources. Wars, strikes and social unrests will discourage investment and business activities.

SOME DIFFICULTIES IN MEASURING NATIONAL INCOME

National Income Accounting is beset with several difficulties. These are:

a. What goods and services to include

Although the general principle is to take into account only those products which change hands for money, the application of this principle involves some arbitrary decisions and distortions. For example, unpaid services such as those performed by a housewife are not included but the same services if provided by a paid housekeeper would be.

Many farmers regularly consume part of their produce with no money changing hands. An imputed value is usually assigned to this income. Many durable consumer goods render services over a period of time. It would be impossible to estimate this value and hence these goods are included when they are first bought and subsequent services ignored.

Furthermore, there are a number of governmental services such as medical care and education, which are provided either 'free' or for a small charge. All these provide a service and are included in the national income at cost. Finally, there are many illegal activities, which are ordinary business and produce goods and services that are sold on the market and generate factor incomes.

b. Danger of Double Counting

The problem of double counting arises because of the inter-relationships between industries and sectors. Thus we find that the output of one sector is the input of another.

If the values of the outputs of all the sectors were added, some would be added more than once, giving an erroneously large figure of national income. This may be avoided either by only including the value of the final product or alternatively by summing the values added at each stage which will give the same result.

Some incomes such as social security benefits are received without any corresponding contribution to production. These are transfer payments from the taxpayer to the recipient and are not included. Taxes and subsidies on goods will distort the true value of goods. To give the correct figure, the former should not be counted as an increase in national income for it does not represent any growth in real output.

c. Inadequate Information

The sources from which information is obtained are not designed specifically to enable national income to be calculated. Income tax returns are likely to err on the side of understatement. There are also some incomes that have to be estimated. Also, some income is not recorded, as for example when a joiner, electrician or plumber does a job in his spare time for a friend or neighbour. Also information on foreign payments or receipts may not all be recorded.

-Black Economy or the illegal economy

-Estimating depreciation

USES OF NATIONAL INCOME FIGURES

1. National Income statistics are also used in comparing the standard of living of a country over time
2. And also the standards of living between countries.
3. National Income Statistics provide information on the stability of performance of the economy over time e.g. a steadily increasing income would be indicative of increasing national income.
4. If National Income Statistics are disaggregated it would enable us to assess the relative importance of the various sectors in the economy. This is done by considering the contribution of the various sectors to Gross National Product over time. Such information is crucial for planning purposes for it reveals to planners where constraints to economic development lie. It therefore becomes possible to design a development_strategy that eventually would overcome these problems. This central contribution could_be in the form of employment or the production of goods and services.
5. By assessing exports and imports as a percentage of Gross national Product i.e. using national statistics, it is possible to determine the extent to which a country depends on external trade.
6. National Income Statistics also help in estimating the saving potential and hence investment potential of a country.
7. Assist the gvt in planning the economy-redistribute wealth, correct adverse trends etc
8. Predict future trends

9. Help investors to understand where to invest

PER CAPITA INCOME

By National Income is meant the value of outputs produced within a year. Income per capita is

simply the National Income divided by the population of the country in a year.

INCOME PER CAPITA = National Income/Population

It shows the standard of living a country can afford for its people. The level of income per capita is determined by the size of a country's population. The higher is the rate of growth of population, the lower is the rate of growth of income per capita.

Per capita income is a theoretical rather than a factual concept. It shows what the share of each individual's National Income would be if all citizens were treated as equal. In a real world situation there exists considerable inequality in the distribution of income especially in the third world countries

PROBLEMS OF USING PER CAPITA INCOME TO COMPARE STANDARD OF LIVING OVER TIME

1) The composition of output may change. e.g. more defence-related goods may be produced and less spent on social services, more producer goods may be made and less consumer goods, and there may be a surplus of exports over imports representing investment overseas. Standards of living depend on the quantity of consumer goods enjoyed.

2) Over time prices will change. The index of retail prices may be used to express the GNP in real terms but there are well known problems in the use of such methods.

3) National Income may grow but this says nothing about the distribution of that income. A small group may be much better off. Other groups may have a static standard of living or be worse off.

4) Social costs. Any increase in GNP per capita may be accompanied by a decline in the general quality of life. Working conditions may have deteriorated. The environment may have suffered from various forms of pollution. These non-monetary aspects are not taken into account in the estimates of the GNP.

5) Finally the national income increases when people pay for services which they previously carried out themselves. If a housewife takes an office job and pays someone to do her housework, national income will increase to the extent of both persons' wages. Similarly a_reduction in national income would occur if a man

painted his house rather than paying a_professional painter to do the same. Changes of the above type mean that changes in the

GNP per capita will only imperfectly reflect changes in the standard of living.

6) Diffences in population

7) Longer working hours

8) Accuracy of data

PER CAPITA INCOME AND INTERNATIONAL COMPARISONS

Per capita income figures can also be used to compare the standards of living of different countries. Thus if the per capita income of one country is higher than that of another country, the living standard in the first country can be said to be higher. Such comparisons are made by aid giving international agencies like the United Nations and they indicate the relevant aid requirements of different countries.

But there are major problems in using real income per head (per capita income) to measure the standard of living in different countries.

First there is the whole set of statistical problems and, secondly, there are a number of difficult conceptual problems or problems of interpretation.

i. Inaccurate estimates of population: The first statistical problem in calculating income per head particularly in less developed countries is that we do not have very accurate population figures with which to divide total income.

ii. Specific items which are difficult to estimate: Another data problem, as already mentioned, is that data for depreciation and for net factor income from abroad are generally unreliable. Hence although we should prefer figures for "the' national income, we are likely to fall back on GDP, which is much less meaningful figure for measuring income per head.

Inventory investment and work-in-progress are also difficult items to calculate.

iii. Non-marketed subsistence output and output of government: some output like subsistence farming and output of government are not sold in the market. These are measured by taking the cost of the inputs. In one country, however, salary of doctors for instance, might be higher and their quality low compared to another country. Although the medical wage bill will be high, the "real consumption" of medical care in the former might be lower. Since "public consumption" is an important element in national income, this could affect comparisons considerably.

Also in making international comparisons it is assumed that the complied national income figures of the countries being compared are equally accurate. This is not necessarily the case.

If, for example, in one country there is a large subsistence sector, a lot of estimates have to be made for self-provided commodities. The national figures of such a country will, therefore, be less accurate than those of a country whose economy is largely monetary or cash economy.

iv. Different degrees of income distribution: If the income of one country is evenly distributed, the per capita income of such a country may be higher than that of another country with a more evenly distributed income, but this does not necessarily mean that most of its people are at a higher living standard.

v. Different Types of Production: If one country devotes a large proportion of its resources in producing non-consumer goods e.g. military hardware, its per capita income may be higher than that of another country producing largely consumer goods, but the standard of living of its people will not necessarily be higher.

vi. Different forms of Published National Income figures: The per capita income figures used in international comparisons are calculated using the published figures of national income and population by each country. For meaningful comparisons, both sets of national income figures should be in the same form i.e. both in real terms or both in money terms, the latter may give higher per capita income figures due to inflation, and thus give the wrong picture of a higher living standard. On the other hand, if both sets are in money terms the countries being compared should have the same level of inflation. In practice, this is not necessarily the case.

vii. Exchange Rates: Every country records its national income figures in its own currency. To make international comparisons, therefore, the national income figures of different countries must have been converted into one uniform currency. Using the official exchange rates does this. Strictly speaking, these apply to internationally traded commodities, which normally form a small proportion of the national production. The difficulty is that these values may not be equivalent in terms of the goods they buy in their respective commodities i.e. the purchasing power of the currencies may not be the same as those reflected in the exchange rate.

viii. Difference in Price Structures: Differences in the relative prices of different kinds of goods, due to differences in their availability, mean that people can increase their welfare if they are willing to alter their consumption in the direction of cheaper goods. The people in poor countries probably are not nearly as badly off as national income statistics would suggest, because the basic foodstuffs, which form an important part of their total consumption, are actually priced very low.

ix. Income in relation to Effort: The first conceptual problem in calculating income per head is to look at goods and services produced in relation to the human effort that has gone into producing them. Obviously if people work harder, they will be able to get more goods; but they may prefer the extra leisure. Indeed, the amount of leisure that people want depends in part on their level of income. Strictly, therefore, we should take income per unit of labour applied. It is largely because this would be statistically awkward that economists prefer to take real income per head.

x. Differences in size: A problem which is both conceptual and statistical is due to the transport factor. If two countries are of different sizes, the large country may devote a large proportion of its resources in developing transport and communication facilities to connect the different parts of the country. This will be reflected in its national income, but the standard of living of its people will not necessarily be higher than that of smaller country, which does not need these facilities to the same extent.

xi. Differences in Taste: Another formidable difficulty is that tastes are not the same in all countries. Also in different countries the society and the culture may be completely different thus complicating comparisons of material welfare in two countries. Expensive tastes are to some extent artificial and their absence in poor countries need not mean a corresponding lack of welfare. Tastes also differ as regards the emphasis on leisure as against the employment of the fruit of labour: if in some societies people prefer leisure and contemplation, who is to say this reduces their welfare as compared to those involved in the hurly-burly of life and labour in modern industry?

xii. Different climatic zones: If one country is in a cold climate, it will devote a substantial proportion of its resources to providing warming facilities, e.g. warm clothing and central heating. These will be reflected in its national income, but this does not necessarily mean that its people are better off than those in a country with a warm climate.

xiii. Income per head as index of economic welfare: We cannot measure material welfare on an arithmetic scale in the same way as we measure real income per head. For instance, if per capita income increases, material welfare will increase; but we cannot say by how much it has increased, and certainly that it has increased in proportion