

76. Define the concept of Net factor Income from Abroad (NFIA) or (NIFA) and Net Exports.

→ NFIA is the difference between factor income earned by our residents who are temporarily residing abroad and factor is earned by non-residence who are temporarily residing in our country.

The difference between exports of goods and services and imports of goods and services in an

accounting year is called Net export. In short,
$$\text{Net export} = \text{Exports of goods and services} - \text{Imports of goods and services.}$$

7. Define :

of goods and services.

- a. Indirect taxes and subsidies.
- b. Market price and factor cost.

→ a. Taxes which are levied by the government on production and sale of commodities are called indirect taxes. Eg: Excise duty, Sales tax, Custom duty etc.

These are called indirect taxes because buyers of a taxed commodity pays the tax indirectly which in fact is included in the price of the commodity.

Indirect tax increases the market price of the taxed commodity.

Subsidies are cash grants given by the govt government to the enterprises to encourage production of certain commodities or to sell goods at prices lower than the free market price. Subsidies reduces the market price of a commodity.

The difference between indirect taxes and subsidies is called ~~net~~ Net Indirect Taxes (NIT)

- b. The difference between market price and factor cost are as under :

Market price includes the impact of subsidies which tend to lower it and impact of ~~indirect~~ indirect taxes which tend to raise it.

Factor cost is free from the impact of both subsidies and indirect taxes. Accordingly national

income at market price is converted into ^{What} ^{nomi}
income at factor cost is converted into N.I. ^{of}
with the following equation :

$$\begin{aligned}\text{N.I. at factor cost} &= \text{N.I. at Market Price} - \text{Indirect tax} + \text{Subsidy} \\ &= \text{N.I. at Market Price} - (\text{Indirect tax} - \text{Subsidies}) \\ &= \text{N.I. at Market Price} - \text{N.I.T.}\end{aligned}$$

= N.I. at Market Price

8. What is the basic difference between N.I. and Domestic income?

→ National Income is the sum total of factor incomes accruing to normal residents of a country. (No matter in which part of the world the income is generated) while domestic income is the sum total of factor incomes generated within the domestic territory of the country. (No matter ~~domestic territory~~ ~~of the country~~ whether the income is accruing to residents or non-residents of the country).

9. Define National Income. Distinguish between nominal national income and real national income.

→ National Income can be defined in three different ways —

Firstly, in terms of production of goods and services (Output approach), N.I. is the market value of all final goods and services produced in the country during a period of 1 year.

Secondly, in terms of factor income (income approach), N.I. is the sum total of rent, wage, interest and profit which accrue to the normal residents of a country as reward for rendering their factor services during one year.

Thirdly, in terms of expenditure approach N.I. is the sum total of expenditure on the purchase of final goods and services in the economy during 1 year.

N.I. can be measured both at current prices and constant prices. When the final goods and services produced in a year are evaluated at current prices it is called ~~the~~ nominal national income, or national income at current prices. On the other hand when the final goods and services are evaluated at some constant prices it is called real national income, or national income at constant prices. Under this method, money value of final good is expressed in terms of prices prevailing in a particular year called the base year. Since prices remain constant for all the years the value of N.I. at constant price changes only because of change in the volume of physical output during the year.

In fact the following distinctions are observed between nominal national income and real national income:—

- i. Real national income is a true indicator of economic growth while nominal national income is not a real indicator of growth.
- ii. While real ~~nom~~ national income is used for making international comparisons, nominal national income cannot be used for such purposes.
- iii. National Income at constant prices is affected only by changes in physical output while national income at current prices is affected by both changes in price and changes in physical output.

13. Define national income deflator. How is it calculated?

→ National income deflator measures the average change in the price of all goods and services that constitute national income. It is calculated as the ratio of nominal national income to real national income multiplied by 100.

$$\text{i.e., } \text{National Income Deflator} = \frac{\text{Nominal N.I.}}{\text{Real N.I.}} \times 100$$

In terms of our above example,

$$\text{National income deflator} = \frac{\text{₹ 2000 cr}}{\text{₹ 800 cr}} \times 100$$

$$= 250$$

Hence, we can say that price level has increased by 150% in the current period (2010) compared to the base period (2005).

~~Let's~~ differs

15. Define :

* i. GDP at market price $(GDP_{MP}) = GNP_{MP} - NFIA$

ii. GDP at factor cost $(GDP_{FC}) = GNP_{FC} - NFIA$

iii. GNP at market price $(GNP_{MP}) = GDP_{MP} + NFIA$

iv. GNP at factor cost $(GNP_{FC}) = GDP_{FC} + NFIA$

v. NNP at market price $(NNP_{MP}) = GNP_{MP} - Dep$

vi. NNP at factor cost $(NNP_{FC}) = GNP_{FC} - Dep$

vii. NDP at market price $(NDP_{MP}) = GDP_{MP} - Dep$

viii. NDP at factor cost $(NDP_{FC}) = GDP_{FC} - Dep$

National & Domestic $\rightarrow$ NFIA

Net & Gross $\rightarrow$ Depreciation

& MP & FC = NIT. i.e. Tax-subsidy

$\rightarrow$ i. GDP_{MP} : It is the market value of all final goods and services produced within the domestic territory of a country during one year, inclusive of depreciation.

ii. GDP_{FC} : It is the sum total of factor incomes (rent + wage + interest + profit) generated within the domestic territory of a country during 1 year, inclusive of depreciation.

iii. GNP_{MP} : It is the ~~market~~ market value of all final goods and services produced by normal residents of a country, during 1 year, inclusive of depreciation.

$$GNP_{MP} = GDP_{MP} + NFIA$$

Chang. GNP_{FC} : It is the sum total of factor incomes earned by normal residents of a country during 1 year, inclusive of depreciation.

v. NNP_{MP} : It is the market value of all final goods and services produced by normal residents of a country during 1 year exclusive of depreciation.

vi. NNP_{FC} : It is the sum total of factor incomes earned by normal residents of a country during 1 year, exclusive of depreciation.

vii. NDP_{MP} : It is the market value of all final goods and services produced within the domestic territory of a country ~~with~~ during 1 year, exclusive of depreciation.

viii. NDP_{FC} : It is the sum total of factor incomes ~~earned~~ generated within the domestic territory of a country during 1 year, exclusive of depreciation.

fees and ~~fees~~ times

1617. Explain the relationship between national income and welfare.

OR.

Does the increase in national income always lead to increase in welfare.

→ It is generally held that rise in national income leads to an improvement in economic well being of the people. The reason is that when real GDP rises, flow of goods and services tends to rise. Other things remaining constant, this means greater availability of goods per person, implying higher level of welfare but this generalisation may not always be true due to the following reasons:—

and represent level of GDP, distribution of GDP: If with every increase in the welfare level of the society may not rise.

ii. Composition of GDP: Composition of GDP may not be welfare oriented even when the level of GDP tends to rise. Eg: The increased production of defence material is having no direct impact on the welfare of mass people.

iii. Non-monetary exchanges: Due to large scale non-monetary transactions, particularly in rural areas, GDP remains underestimated and is therefore not a proper index of welfare.

iv. Externalities: In the production process some benefits (or harms) are caused for which people are not paid. (or paralysed). These benefits (or harms) are called externalities. Now if we consider National income as a measure of welfare of the country, we shall be overestimating the actual welfare in case of negative externality, and underestimating the actual welfare in case of positive externality.

35. Explain the value added method of estimating N.I.

→ If we add the gross value added of all firms of the economy in a year, we get a measure of the value of aggregate amount of goods and services produced by the economy in that year. Such an estimate is called gross domestic product at market price. (GDP_{MP}). If we consider that there are 'n' firms in an economy then ~~GDP_{MP}~~

$GDP_{MP} = \sum_{i=1}^n GVA_i$. Let us now look at the steps

$$\rightarrow \therefore NDP_{MP} = \sum_{i=1}^n GVA_i - Dep \Rightarrow NNP_{MP} = NDP_{MP} + NFIA \Rightarrow NNP_{MP} = NNP_{FC}$$

that are undertaken to measure N.I. by product method or value added method. —

First of all, all production units within the domestic territory are classified into 3 distinct sectors

— Primary, secondary and ~~tertiary~~ tertiary.

Secondly, we know that NVA_i (Net Value Added by the i^{th} producing unit at Market Price) is the gross value added at Market price ~~is~~ — depreciation i.e., $NVA_i = GVA_i - D_i$. Therefore,

$$GVA_i = NVA_i + D_i.$$

But since there are 'n' firms in the economy, hence GDP_n for the entire economy will be

$$GDP_{MP} = \sum_{i=1}^n NVA_i + \sum_{i=1}^n D_i$$

Now Σ of NVA of all firms in the economy gives NDP_{MP} . Symbolically,

$$NDP_{MP} = \sum_{i=1}^n NVA_i$$

Thirdly, when net indirect taxes are subtracted from NDP_{MP} , we get NDP_{FC} . Therefore,

$$NDP_{FC} = NDP_{MP} - NIT$$

In the last step when net income from abroad (NFIA) is added to NDP_{FC} , we get NNP_{FC} or N.I. In other words, $NNP_{FC} = NDP_{FC} + NFIA$

36 - Explain the income method of estimating N.I.

called distributed share

54. Explain the expenditure method of measuring N.I. etc.

→ We know that expenditure is undertaken by all sectors of the economy viz., households, firms, govt. and rest of the world. Following are the different kinds of expenditure incurred by these different sectors :

i. Private Consumption Expenditure : It is the money value of all final goods and services purchased by the households. This includes consumption of

a. ~~Consumer~~ Consumer durables such as T.V. sets, electric fans etc.

b. Non-durable goods such as vegetables, fish, meat, milk etc.

c. Consumer services such as banking and insurance services, medical facilities etc.

ii. Govt. final consumption expenditure : The value of govt. final consumption expenditure is the sum total of the following items :

a. Compensation of employees paid by the govt.

b. Goods and services purchased by the govt. from domestic market.

c. Net purchases from abroad by the govt.

iii. Gross fixed Capital formation : It consists of

a. purchase of new assets within the domestic market like buildings, machinery, transport equipment

etc.

b. Import of new assets

c. Self production of new assets like rail engines, wagons, farm machinery, sheep, buffaloes etc.

d. Purchase of new houses by the household etc.

iv. Change in stocks : Unsold stocks left with the producers are assumed to be purchased by the producers themselves. That is why change in stock is also considered as final investment expenditure.

v. Net exports : It is the difference between exports and imports of a country during the period of one year. It is estimated by deducting the value of imports from the value of exports of goods, raw materials.

By adding up all the items of final consumption expenditure and investment expenditure of the domestic economy, we get GDP_{MP} , i.e.,
 $GDP_{MP} = \text{Private Consumption Expenditure} + \text{govt. final consumption expenditure} + \text{gross fixed capital formation} + \text{change in stocks} + \text{net exports}.$

By adding NFIA to GDP_{MP} we get GNP_{MP} . At the last step by subtracting dep. & NIT from GNP_{MP} we get NNP_{FC} as follows :-

$$NNP_{FC} = GNP_{MP} - \text{Dep} - \text{NIT}$$

55. What precautions must be taken for correct estimation of NI by all three different methods?

→ Precautions for value added method :

- i. The sale and purchase of second hand goods should not be included in N.I.
- ii. The value of retained goods for self-consumption should be ~~included~~ included.
- iii. Domestic services are not included in N.I. However, production of such services by paid employees ~~is~~ should be included.
- iv. Double-counting needs to be avoided.

Precautions for income method :

- i. To avoid transfers : N.I. includes only factor payments. Any payment for which no service is rendered is called a transfer and should not be included in N.I.
- ii. To avoid capital gains : Capital gains refer to income from the sale of financial assets, such as bond, securities etc. These transactions are not production transaction and ~~hence~~ hence not included in N.I.
- iii. To include income from self employed consumed output : ~~When~~ When a house owner lives in that house, he ~~do~~ does not pay any rent

2. But in fact he pays rent to himself. Since rent is a payment for services rendered. Even though rendered to the owner itself it must be counted as a factor payment.

3. iv. Illegal income :- Income from illegal activities like smuggling, theft, gambling etc should not be included in N.I.

Precautions for expenditure method :

i. Expenditure on intermediate goods :- Expenditure incurred by the producers on intermediate goods is not included in N.I. otherwise it will lead to the problem of double counting.

ii. Expenditure on second hand goods :- All expenditures on second hand goods are excluded as they have already been included when these goods were purchased.

iii. To avoid transfer expenditure :- A transfer payment is a payment against which no service is rendered. Since no production of good or service takes place, it has no place in N.I.

iv. Include self use own produced final goods :- For example a house owner using the house for self. Although he does not incur any expenditure but he is making payment of rent to himself. Since the house is

producing a service, value of this and must be included in N.I.

56. What is the problem of double counting? Explain with the help of an example.

→ The problem of double counting is the problem of estimating the value of goods and services more than once. This is because while estimating N.I. by output method the value of only final goods and services is taken into consideration. As far as an enterprise is concerned, its sales are treated as final sales. Eg: A farmer produces 1 tonne of wheat and sells it for ₹400 in the market to a ~~flour~~ flour mill. As far as the farmer is concerned the sale of wheat is a final sale and he gets ₹400 for it. If he does not have to incur any expenditure on the cultivation of wheat, ₹400 becomes value added by him. The purchase of wheat by the flour mill is an intermediate good. It converts wheat into flour and sells it for ₹600. The value added by the flour mill is $₹600 - ₹400 = ₹200$. Now, in the estimation of N.I. if both the final sales figure (₹400 & ₹600) of the farmer & owner of the flour mill are included, there will be the problem of double counting.