# National Income

**EXERCISE [PAGE 69]**

**Exercise | Q 1.1 | Page 69**

Complete the following statement:

While estimating national income, we include only the value of final goods and services in order to _____.

1. make computation easier

**2. avoid double counting**

3. maximize national welfare of the people

4. evaluate the total economic performance of a nation

**Solution:** While estimating national income, we include only the value of final goods and services in order to **avoid double counting.**

**Exercise | Q 1.2 | Page 69**

Complete the following statement:

NDP is obtained by _____.

1. deducting depreciation from GNP

**2. deducting depreciation from GDP**

3. including depreciation in GDP

4. including depreciation in GNP

**Solution:**  NDP is obtained by **deducting depreciation from GDP**.

**Exercise | Q 1.3 | Page 69**

Complete the following statement:

In India, national income is estimated using _____.

1. output method

2. income method

**3. expenditure method**

4. combination of output and income method

**Solution:** In India, national income is estimated using **expenditure method**.

**Exercise | Q 2.1 | Page 69**

Complete the Correlation:

_____ : C + I + G + (X-M) :: GNP : C + I + G + (X-M) + (R-P).

**Solution: <u>GDP</u>** : C + I + G + (X-M) :: GNP : C + I + G + (X-M) + (R-P).

**Exercise | Q 2.2 | Page 69**

Complete the Correlation:

Output method : _____ :: Income method : Factor cost method

**Solution:** Output method : **<u>product method or inventory method</u>** :: Income method :

Factor cost method

**Exercise | Q 2.3 | Page 69**

Complete the Correlation:

Theoretical difficulty : Transfer payments :: _____ : Valuation of Inventories

**Solution:** Theoretical difficulty : Transfer payments :: **<u>Practical Difficulty</u>** : Valuation of

Inventories

**Exercise | Q 3.1 | Page 69**

Choose the correct option:

Wrongly matched pair:

a) National Income Committee – 1949

b) Financial year – 1st April to 31st March

c) Income method – National Income = Rent + Wages + Interest + Profit+ Mixed income
+ Net Income from abroad

d) Expenditure method – National Income = Rent + Wages + Interest + Profit

1. a
2. b
3. c
**4. d**

**Solution:** d

**Exercise | Q 5.1 | Page 69**

Answer the following:

Explain the two-sector model of the circular flow of national income.

**Solution: Two sector model of Circular flow of National Income:**

There are two sectors, households and firms. It divides the diagram into two parts. The upper half represents the factor market and the lower half represents the commodity market. Fig. explains the circular flow of income and expenditure in a two-sector model.
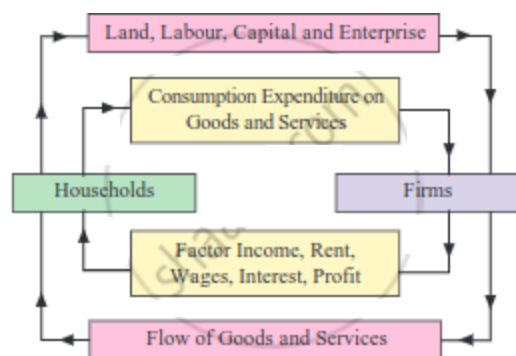
In the above figure the factors of production flow from the households to the firms. The firms use these factors to produce goods and services required by households. Thus, goods flow from the households to the firms and from the firms back to the households. It is called product flows. In the same way, money flows from the firms to the households in the form of factor payments such as rent, wages, interest and profit. Households use this income to purchase goods and services. Thus, money flows from the firms to the households and from the households back to the firms. It is called money flows. In the circular flow of income, production generates factor income, which is converted into expenditure. This flow of income continues as production is a continuous activity due to never-ending human wants.

### Exercise | Q 5.2 | Page 69

Answer the following:

Explain the importance of national income.

**Solution: The following points explain the importance of the National Income:**

1. **For the Economy:** National income data are important for the economy of a country. In present times, the national income data are regarded as accounts of the economy, which are known as 'Social Accounts'. It tells us how the aggregates of a nation's income, output, and product result from the income of different individuals, products of industries, and transactions of international trade.
2. **National policies:** National income data forms the basis of national policies such as employment policy, industrial policy, agricultural policy, etc. National Income also helps to generate economic models like growth models, investment models, etc. Thus, proper measures can be adopted to bring the economy to the right path.
3. **Economic planning:** For economic planning, data pertaining to national income is very essential. This includes data related to a country's gross income, output, savings, investment, and consumption which can be obtained from different sources.
4. **Economic Research:** National income data are also used by the research scholars of economics. They make use of various data of the country's input, output, income, savings, consumption, investment employment, etc., which are obtained from social accounts.
5. **Comparison of Standard of Living:** National income data helps us to compare the standards of living of people in different countries and of people living in the same country at different times.

6. **Distribution of Income:** National income statistics enable us to know about the distribution of income in the country from the data related to wages, rent, interest, and profits. We understand the disparities in the incomes of different sections of society.

**Exercise | Q 5.3 | Page 69**

Write short answer for the following question :

Explain features of National Income.

**Solution:**

**Features of National Income**

1. **Macroeconomic concept:** The National income is a study of the Macroeconomics concept. It is the aggregate income of all goods and services produced in a country during a given year. It provides a clear picture country's economic performance during a particular year.
2. **Flow concept:** National income is a flow concept i.e. flow of goods and services produced in the economy during a year. It varies according to variations in production within the country. National income flows only if there is productivity activity in the economy.
3. **Real terms and Money Terms:** The national income can be expressed in real terms as well as in money terms.
   - **Real National Income:** when national income is expressed as a flow of goods and services produced in the economy in a year, it is called as real national income.
   - **Money National Income:** When national income is expressed as the value of all goods and services produced in the economy during a year, it is called money national income.
4. **Value of final goods and services:** While calculating national income, only the value of final goods and services is included. The value of intermediate goods such as raw materials is not included. This is done to avoid double counting.
5. **Transfer Income:** While calculating national income, the transfer income in the form of old-age pension, unemployment allowances, scholarships, etc., is not included. The transfer income is received by receipts without providing any factor unit such as labour, capital, etc.
6. **Financial Year:** In India, the national income is estimated by the Central Statistical Organisation. It is annually estimated and measured for a financial year beginning from 1st April and ending on 31st March.
7. **Net income from Abroad:** While calculating national income the net income received from abroad are included. The net income from abroad includes the difference between exports and imports, as well as net income from investments abroad. If the net income is negative, then that amount is deducted from national income.

**Exercise | Q 5.4 | Page 69**

Answer the following:

Explain the concept of Green GNP.

**Solution:**

**Concept of Green GNP:**

It is defined as, "Green GNP is an indicator of sustainable use of the natural environment and equitable distribution of benefits of development."

Gross National product does not take into consideration the cost in terms of (i) Environmental pollution, (ii) Depletion of natural resources caused by the production of output. A mere increase in GNP will not reflect an improvement in the quality of life when it increases environmental pollution or reduces available resources for future generations. So Green GNP has been introduced while measuring economic welfare.

**The following are the characteristics of Green GNP:**

1. Sustainable economic development, i.e. development which should not cause environmental degradation (pollution) and depletion of natural resources.
2. Equitable distribution of benefits of its development.
3. Promotes economic welfare for a long period of time.

**Measurement:**

Green GNP = GNP - (Net fall in the stock of natural capital + pollution load.)

### Exercise | Q 6.1 | Page 69

State with reason, whether you agree or disagree with the following statement:

There are many theoretical difficulties in the measurement of national income.

1. **Agree**
2. Disagree

**Solution: Agree**

There are many theoretical difficulties in the measurement of national income for examples,
Transfer payments, Illegal income, Unpaid services, production for self-consumption and so many.

### Exercise | Q 6.2 | Page 69

State with reason, whether you agree or disagree with the following statement:

Under the output method, value-added approach is used to avoid double counting.

1. **Agree**
2. Disagree

**Solution: Agree**

In order to avoid double-counting value-added approach is used. According to this approach, the value-added at each stage of the production process is included. The difference between the value of final outputs and inputs, at each stage of production, is called the value-added.

### Exercise | Q 7.1 | Page 69

Answer in detail:

Explain the practical difficulties involved in the measurement of national income.

**Solution:** Following are the difficulties in the measurement of national income:

- **Problem-related to double counting**: One of the major problems involved in the estimation of national income by the value-added method is the problem of double counting. Double counting refers to a situation where the value of a good is taken into account (counted) more than once. Such a problem occurs because, for every producer, the commodity he sells is the final commodity. Thus, if the value of the good is taken into account every single time, it leads to the estimating of the value of the product more than once.
- **Estimation regarding depreciation**: During the process of production, along with the raw materials and inputs, various fixed assets such as machinery, tools, etc. are also used. However, during the course of production, the fixed assets undergo wear and tear. This wear and tear reduce the value of the fixed assets of business entities. Since depreciation is based on various assumptions and is subjective in nature, it is difficult for an individual to correctly assess the deduction to be made for depreciation.
- **Self-consumption**: At times, the producer or firm keeps a certain portion of the output for self-consumption. Such a portion of production that is retained for self-consumption should be included in the estimation of national income, but it is difficult to calculate such consumption and production.
- **Windfall gains and capital gains**: Windfall gains such as lotteries and capital gains are unearned income and are not included in the estimation of the national income. However, these activities very much add to the national product.
- **Valuation of inventories:** Raw materials, intermediate goods, semi-finished and finished products in the stock of the producers are known as inventories. Any mistake in measuring the value of inventory will distort the value of the final production of the producer. Therefore, the valuation of inventories requires careful assessment.
- **Illiteracy and ignorance:** Due to ignorance and illiteracy, small producers do not keep an account of their production. So they cannot give information about the quantity or value of their output.

### Exercise | Q 7.2 | Page 69

Answer in detail:

Explain the income method and expenditure method of measuring national income.

**Solution:**
- **Income Method:**
  This method of measuring national income is also known as the factor cost method.
  This method estimates national income from the distribution side.
  GNP can be treated as the sum of factor incomes, earned as a result of undertaking the 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)

- **Expenditure Method:**
  This method of measuring national income is also known as the 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, GNP according to the expenditure method, is calculated as follows:
  NI = C + I + G + (X–M) + (R–P)