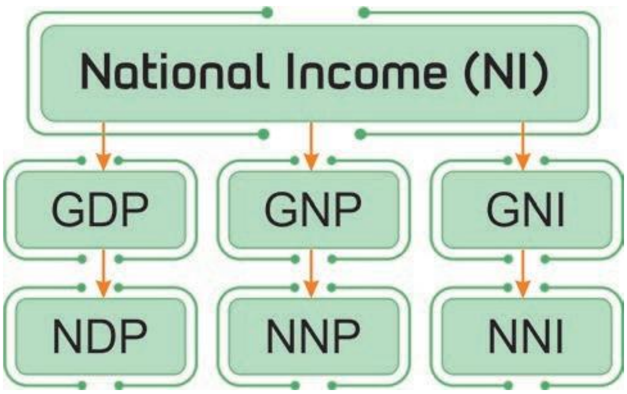
2 National Income

National Income

- It is the sum of income earned by its residents from the factor services rendered to the production units, both within and outside the geographical boundaries of the country.
  - **National:** It refers to the residents whose economic interests lie within the country in which they live.
  - **Factor Income:** It is the income derived from factors of production such as Land, Labour, Capital and Entrepreneurship.

Measures of National Income



National Income Accounting

- These are the set of statistical principles and methods used to measure overall economic activities of the nation.
- These also provide information about the trend of economic activities.
- While accounting National Income (NI), only the income earned by the residents is taken into account, irrespective of their economic territory.
- It may be within or outside the economic territory, i.e. we must see whether the income is generated by residents or non-residents.

Significance of National Income Accounting

- It helps in comparing estimates, forecasting growth, and policy formulation for the future.
- It helps in comparing economies around the world.
- It is helpful in effective decision making on investments, thereby helping business houses to plan for productions.

Concept of Factor Cost, Basic Price and Market Price

Factor Cost

- Factor cost refers to the cost of factors of production such as land, labour, capital and entrepreneurship which is incurred by a firm when producing goods and services.
- It is the cost of all the factors of production used in producing goods and services.
- It does not include the taxes that are paid to the government since taxes are not directly involved in the production process and therefore are not a part of the direct production cost.
- Subsidies received are included in the factor cost as subsidies are given on inputs used in production.

Factor Cost = Cost of Production + Subsidies

Basic Price

- It is the price received by the producer, excluding the product taxes and including the product subsidies.
- It also excludes any transport charges invoiced separately by the producer.

Basic Price = Price received by the Producer - Product Taxes + Product Subsidies

Market Price

- It is the price set after all the levels of value additions, and at which goods and services are sold or offered in the marketplace.

- In a free market economy, the market price is often referred to as retail price and it may fluctuate based on demand and supply.

Market Price (MP) = Cost of Production + Indirect Taxes - Subsidies

Important Notes

- Prior to 2015, GDP was estimated at factor cost.
- From 2015 onwards, Gross Value Added (GVA) at basic prices is used to calculate GDP at market price.
- The shift from factor costs to market prices indicates that India is conforming to international standards such as System of National Accounting (SNA) of the UN, which is used by most of the countries.
- The difference between GDP at factor cost and GVA at basic prices is that production taxes are included, and production subsidies excluded from the latter.
- Production taxes and production subsidies are different from product taxes and product subsidies.
- Production taxes are imposed even if the products are not produced, such as taxes on property.
  - However, excise duty, value added tax, etc., are all product taxes (or, indirect taxes).
- Likewise, product subsidies would not include interest subsidies, which will form part of production subsidies.
- Therefore, GDP at market prices is brought out by adding product taxes and deducting product subsidies from GVA at basic prices.

Gross Value Added (GVA)

- It is a measure of total output and income in the economy.
- It provides rupee value for the amount of goods and services produced in an economy after deducting the cost of inputs and raw materials that have gone into the production of goods and services.
- It gives a sector-specific picture of growth in an area such as industry, agriculture, manufacturing etc.
- **Classification Good or Service as Intermediate Consumption**
  - It is purchased or acquired from another production unit.
  - It is acquired for resale, which amounts to being used up entirely in the course of production during the accounting period.

GVA = Value of Gross Output - Value of Intermediate Consumption

- In the revision of National Accounts statistics done by Central Statistical Organization (CSO), it was decided that while computing GDP, sector-wise estimates of Gross Value Added (GVA) will now be given at basic prices instead of factor cost.
- GVA at basic prices will include production taxes and exclude production subsidies available on the commodity.

GVA (at Basic Price) = GVA (at Factor Cost) + Production Taxes - Production Subsidies

- GVA at factor cost includes no taxes and excludes no subsidies.
- While calculating GDP at market prices, it includes both production and product taxes, and excludes both production and product subsidies.

Gross Domestic Product (GDP)

- It is the market value of all final goods and services produced within the territory of the country during a financial year.
- However, it can also be computed quarterly or half-yearly.
- It is estimated by the Central Statistical Office (CSO).
- The Ministry of Finance uses the GDP numbers (at current prices) to peg the financial targets [as per the Fiscal Responsibility and Budget Management Act (FRBM), 2003].

Methods of Calculating GDP

Production Method

- It is also known as the Value Added or the Output Method.
- In this method, the value of the final product of the primary, secondary and tertiary sector is included, and the transfer payments viz., scholarships, pensions etc. are excluded. Production by unwarranted or illegal activities is also excluded.
- The total Market Price of the final produce should be equal to the Gross Value Added. Therefore, the GDP can be calculated using the Product or Value Added Method.

GDP using Value Added Method
GDP (at Factor Cost) = GVA (at Basic Price)
GDP (at Market price) = GVA (at Basic Price) + Product Taxes - Product Subsidies