



# **NATIONAL INCOME AND RELATED AGGREGATE**

## **PART 1<sup>st</sup>**

### **1. BASIC CONCEPT OF MACRO ECONOMICS**

#### **AND**

### **CIRCULAR FLOW OF INCOME**

## **MEANING OF NATIONAL INCOME ACCOUNTING**

**National income accounting can be defined as a set of systematic statistical statements which depict the measurement and inter - relationships among macroeconomics aggregates.**

**National income accounting performs two basic functions:**

- (i) It measures the economic performance of an economy,**
- (ii) Evaluation and review of the economic policies of the country.**

## **IMPORTANCE AND USES OF NATIONAL INCOME ACCOUNTING**

- 1. Indicator of the economic Performance**
- 2. Measurement of economic development**
- 3. Distribution of income**
- 4. Knowledge of structural changes**

## **5. Comparisons**

### **BASIC CONCEPTS OF MACROECONOMICS PRODUCTION PROCESS**

**Activities relating to the production of the goods and services by combining and utilizing the services of various factors of production is called production process.**

#### **INTERMEDIATE GOODS**

**Goods which are used for further production or for resale in the same year are known as intermediate goods. When intermediate goods pass through the production process, they lose their identity.**

#### **FINAL GOODS**

**Goods which are used either for final consumption by the consumers or for investment by the producers are called final goods.**

### **TREATMENT OF GOODS AS INTERMEDIATE OR FINAL GOODS**

**INTERMEDIATE GOODS - They include:**

**i. Non - durable goods and services used by the producers as raw materials, oils, electricity, coal, fuel etc. and services of engineers, technician, manager etc.**

**ii. Goods lying with the traders for the resale in the same year.**

**iii. Durable goods which are used primarily for military purposes by the government such as cars, air conditioners, trucks, buildings, air crafts, submarines, other armaments, etc.**

### **FINAL GOODS:**

**They includes:**

**(i) All durables consumer goods used by the consumers like bicycle, scooters, cars, radio, televisions, refrigerators, Fans, and furniture, etc.**

**(ii) All non - durable consumer goods and services like wheat, milk, bread, pencil etc. and services of doctors, teachers, household servants, etc.**

**(iii) All capital goods used by the producers like machines, trucks, tractors, etc.**

### **TYPES OF FINAL GOODS**

**Final goods can be of two types: consumption goods and capital goods.**

## **CONSUMPTION GOODS**

**Goods which are capable of satisfying human wants directly. Examples are: milk, bread, sugar, tea, watch, shoes, radio, fruit, vegetables, furniture, etc.**

## **CAPITAL GOODS**

**All goods which help in the production of other goods either as fixed assets or as inventory stocks are called capital goods. Examples of fixed assets are: machines, plants, tool, and implements, buildings etc.**

## **THE CONCEPTS OF STOCKS AND FLOWS**

**In the economics, we use two types of variables: stock variables and flow variables.**

**A stock is a quantity of any economics variable which is measured at a particular point of time. A flow is a quantity of any economic variable which is measured during a period of time (or per unit of time), say, a week, a month or a year.**

## **GROSS INVESTMENT, NET INVESTMENT AND DEPRICIATION**

**Investment (or capital formation) is defined as the addition to the existing stock of real capital assets.**

**In national income accounting we use the two forms of investment: gross investment and net investment.**

### **GROSS INVESTMENT**

**The total capital formation (or the total investment) in a given period in an economy is termed as gross investment.**

**Gross Investment = Stock Investment + Gross Fixed Capital Investment**

### **Net Investment**

**The capital goods suffer wear and tear and obsolescence during the production process. This is known as capital depreciation. Thus,**

**Net Investment = Gross Investment - Depreciation or**

**Gross Investment - Net Investment + Depreciation or**

**Depreciation = Gross Investment - Net Investment**

### **DEPRECIATION OR CAPITAL CONSUMPTION ALLOWANCE**

**During the process of production these capital assets go down in value due to the following reasons:**

**(i) Normal wear and tear**

**(ii) Foreseen (expected) Obsolescence**

### **Calculation of Depreciation**

**Annual amount of depreciation = Original value of the machine / no. of year of the life of the machine**

### **FACTOR OF PRODUCTION AND FACTOR INCOMES**

**Factors which help in the production of goods are called factors of production. They are also known as inputs (or factor inputs) and whatever they produce are called output.**

**There are four major factors of production: Land, labour, capital, enterprise (or entrepreneur).**

### **CIRCULAR FLOW OF INCOME**

**Production, exchange and consumption are important economic activities of an economy. In carrying out these economic activities,**

**people are involved in making transactions between different sectors of economy. Because of these transactions, income move in a circular flow in an economy. This is called circular flow of income.**

## **PRINCIPLES OF CIRCULAR FLOW OF INCOME**

**The circular flow of income and product is based on two basic principles:**

**(i) The amount of spending by the buyers / consumers becomes the receipt and income of the seller / producers.**

**(ii) Goods and services flow in one direction from seller to the buyer while money payments for these Goods and services move in the opposite direction.**

## **CIRCULAR FLOW OF INCOME IN A TWO - SECTOR ECONOMY**

**The two-sector model presumes only two sectors in the economy: household sector and firm sector. Household are the owners of all factor of production and consumers of goods and services. Firms produce and sell goods and services to the households.**

**In this model our assumption are as follows:**



**(i) There are only two sectors in the economy; household sector and business firms.**

**(ii) Household sectors are owners of factors of production and supply factor services to the firms.**

**(iii) Firms produce goods and services and sell their entire output to the households.**

**(iv) Households receive income for their factor- services and spend their entire amount on consumption**

**(v) No savings in the economy.**

**(vi) There is no government sector.**

**(vii) It is a closed economy, i.e. , there are no exports or imports with the rest of the world.**

**When firms get factor - services from houses, they make monetary payments against them to the households (or owners of factors).**

**These payments are made as wages to the workers, rent to landowners, interest to capitalists, and profit to entrepreneurs. These monetary payments are factor - incomes for households and cost expenditures for the firms. Households spend this income on the**

**purchase of goods and services, total money receipt of the firm is same as the total income of households.**

## **CIRCULAR FLOW OF INCOME IN A FOUR - SECTOR ECONOMY**

**Suppose there are four sectors in the economy: Household, Firms, Government and Rest of the world (or External Sector). There are household savings also in the economy. Saving of the people reach the capital market in some or the other form where firms borrow funds for investment purposes. Thus, household income (Y) is divided into two parts: (i) Consumption expenditure (C), and (ii) Savings (S). The consumption and savings take different routes to reach the business firm sector. The consumption carefully flows directly to the firms, whereas savings are routed through the capital market. Note that savings (S) take ultimately the form of investment (I). Thus, at the level of equilibrium, savings and investment are always equal.**

**The condition for equilibrium in a four sector economy can be stated as follows:**

$$\mathbf{C + S + T = C + I + G + (X - M)}$$

**Here, C = Consumption; S = Savings; I = Investment; T = Tax revenue; G = Government Expenditure; X = Exports; M = Import; (X - M) = Net Exports.**