Idhaya College for Women Kumbakonam

PG & Research Department of Commerce

I BCom

Business Economics - 16CACCM1B

Unit – V

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Unit – V

NATIONAL INCOME

Meaning

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. national income means the total value of goods and services produced annually in a country.

Definition

"National income is that part of objective income of the community, including of course income derived from abroad which can be measured in money."

- A.C. Pigou

Concepts of National Income

There are a number of concepts pertaining to national income and methods of measurement relating to them.

(A) Gross Domestic Product (GDP)

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as "the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year."

There are three different ways to measure GDP:

- Product Method
- Income Method
- Expenditure Method

1. The Product Method

In this method, the value of all goods and services produced in different industries during the year is added up. This is also known as the value added method to GDP or GDP at factor cost by industry of origin. The following items are included in India in this: agriculture and allied services, mining, manufacturing, construction, electricity, gas and water supply; transport, communication and trade; banking and insurance, real estates and ownership of dwellings and business services; and public administration and defense and other services (or government services). In other words, it is the sum of gross value added.

2. The Income Method

The people of a country who produce GDP during a year receive incomes from their work. Thus GDP by income method is the sum of all factor incomes: Wages and Salaries (compensation of employees) + Rent + Interest + Profit.

3. Expenditure Method

This method focuses on goods and services produced within the country during one year.

(B)Net Domestic Product (NDP)

NDP is the value of net output of the economy during the year. Some of the country's capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP. Thus Net Domestic Product = GDP at Factor Cost – Depreciation.

Methods of Measuring National Income

There are four methods of measuring national income. Which method is to be used depends on the availability of data in a country and the purpose in hand.

(1) Product Method

According to this method, the total value of final goods and services produced in a country during a year is calculated at market prices. To find out the GNP, the data of all productive activities, such as agricultural products, wood received from forests, minerals received from mines, commodities produced by industries, the contributions to production made by transport, communications, insurance companies, lawyers, doctors, teachers, etc. are collected and assessed at market prices. Only the final goods and services are included and the intermediary goods and services are left out.

(2) Income Method

According to this method, the net income payments received by all citizens of a country in a particular year are added up, i.e., net incomes that accrue to all factors of production by way of net rents, net wages, net interest and net profits are all added together but incomes received in the form of transfer payments are not included in it. The data pertaining to income are obtained from different sources, for instance, from income tax department in respect of high income groups and in case of workers from their wage bills.

(3) Expenditure Method

According to this method, the total expenditure incurred by the society in a particular year is added together and includes personal consumption expenditure, net domestic investment, government expenditure on goods and services, and net foreign investment. This concept is based on the assumption that national income equals national expenditure.

(4) Value Added Method

Another method of measuring national income is the value added by industries. The difference between the value of material outputs and inputs at each stage of production is the value added. If all such differences are added up for all industries in the economy, we arrive at the gross domestic product

Importance of National Income Analysis

1. For the Economy:

National income data are of great importance for the economy of a country. These days the national income data are regarded as accounts of the economy, which are known as social accounts. These refer to net national income and net national expenditure, which ultimately equal each other.

Social accounts tell 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. Their main constituents are inter-related and each particular account can be used to verify the correctness of any other account.

2. National Policies

National income data form the basis of national policies such as employment policy, because these figures enable us to know the direction in which the industrial output, investment and savings, etc. change, and proper measures can be adopted to bring the economy to the right path.

3. Economic Planning

In the present age of planning, the national data are of great importance. For economic planning, it is essential that the data pertaining to a country's gross income, output, saving and consumption from different sources should be available. Without these, planning is not possible.

4. Economic Models

The economists propound short-run as well as long-run economic models or long-run investment models in which the national income data are very widely used.

5. Research

The national income data are also made use of by the research scholars of economics. They make use of the various data of the country's input, output, income, saving, consumption, investment, employment, etc., which are obtained from social accounts.

6. Per Capita Income

National income data are significant for a country's per capita income which reflects the economic welfare of the country. The higher the per capita income, the higher the economic welfare of the country.

7. Distribution of Income

National income statistics enable us to know about the distribution of income in the country. From the data pertaining to wages, rent, interest and profits, we learn of the disparities in the incomes of different sections of the society. Similarly, the regional distribution of income is revealed.

INEQUALITIES OF INCOME

MEANING

In a society of varied people with variety of talents and powers of work, the rewards cannot be identical .the cry of equal income for all.

CAUSES OF INEQULITY OF INCOME

- Capitalistic tinge
- System of private property
- The law of inheritance
- Mobility of factors
- Occupational difference
- Supply of labour

FISCAL POLICY

Meaning

Fiscal policy is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy. It is the sister strategy to monetary policy through which a central bank influences a nation's money supply.

Definition

Fiscal policy as “changes in government expenditure and taxation designed to influence the pattern and level of activity.” -Harvey and Joanson

Fiscal policy as “changes in taxes and expenditure which aim at short run goals of full employment price level and stability.” **-**Otto Eckstein

Objectives of a Fiscal Policy

- In order to stabilize the pricing level in the economy.
- The main objective is to achieve and maintain the level of full employment in the country.
- To stabilize the growth rate in the economy.

- To promote the economic development in a country.
- In order to maintain the level of balance of payment in the economy.

Types of Fiscal Policy

❖ Expenditure Policy

Government expenditure includes capital expenditure and revenue expenditure. Also, the government budget is the most important instrument that embodies government expenditure policy. Furthermore, the budget is also for financing the deficit. Thus, it fills the gal between income and government spending.

❖ Taxation Policy

The government generates its revenue by imposing both indirect taxes and direct taxes. Thus, it is important for the government to follow a judicial system for taxation and impose correct tax rates. This is because of two reasons. The higher the tax, the reduction in the purchasing power of the people.

❖ Surplus and Debt Management

When the government receives more amount than it spends than it is known as surplus. Also, when the spending is more than the income than it is known as a deficit. In order to fund the deficits, the government needs to borrow from domestic or foreign sources.

Advantages of Fiscal Policy of India

1. Capital Formation

Fiscal policy of the country has been playing an important role in raising the rate of capital formation in the country both in its public and private sectors. The gross domestic capital formation as per cent of GDP in India has increased from 10.2 per cent in 1950-51 to 22.9 per cent in 1980-81 and then to 24.8 per cent in 1997-98. Therefore, it has created a favourable impact on the public and private sector investment of the country.

2. Mobilisation of Resources

Fiscal policy of the country has been helping to mobilize considerable amount of resources through taxation, public debt etc. for financing its various developmental projects. The extent of internal resources mobilisation for financing plan has increased considerably from 70 per cent in 1965-66 to around 90 per cent in 1997-98.

3. Incentives to Savings

The fiscal policy of the country has been providing various incentives to raise the savings rate both in household and corporate sector through various budgetary policy changes, viz., tax exemption, tax concession etc. Accordingly, the saving rate has increased from a mere 10.4 per cent in 1950-51 to 23.1 per cent in 1997-98.

4. Inducement to Private Sector

Private sector of the country has been getting necessary inducement from the fiscal policy of the country to expand its activities. Tax concessions, tax exemptions, subsidies etc. incorporated in the budgets have been providing adequate incentives to the private sector units engaged in industry, infrastructure and export sector of the country.

5. Reduction of Inequality

Fiscal policy of the country has been making constant endeavor to reduce the inequality in the distribution of income and wealth. Progressive taxes on income and wealth tax exemption, subsidies, grant etc. are making a consolidated effort to reduce such inequality. Moreover, the fiscal policy is also trying to reduce the regional disparities through its various budgetary policies.

6. Export Promotion

The Fiscal policy of the government has been making constant endeavor to promote export through its various budgetary policy in the form of concessions, subsidies etc. As a result, the growth rate of export has increased from a mere 4.6 per cent in 1960-61 to 10.4 per cent in 1996-97.

7. Alleviation of Poverty and Unemployment

Another important merit of Indian fiscal policy is that it is making constant effort to alleviate poverty and unemployment problem through its various poverty eradication and employment generation programmes, like, IRDP, JRY, PMRY, SJSRY, EAS etc.

PUBLIC FINANCE

Meaning

Public finance is the management of a country's revenue,expenditures, and debt load through various government and quasi-government institutions. This guide provides an overview of how public finances are managed, what the various components of public finance are, and how to easily understand what all the numbers mean. A country's financial position can be evaluated in much the same way as a business' financial statement.

Definition

Public finance is "concerned with the income and expenditure of public authorities and with the adjustment of one to the other." - Dalton

Scope of Public Finance

The scope of public finance into four areas as follows :

- ### Public Income

As the name suggests, public income refers to the income of the government. The government earns income in two ways – tax income and non-tax income. Tax income is easy to recognize, it's the tax paid by people of the country in the form of income tax, sales tax, duties, etc. On the other hand non-tax income includes interest income from lending money to other countries, rent & income from government properties, donations from world organizations, etc.

- ### Public Expenditure

Public expenditure is the money spent by government entities. Logically, the government is going to spend money on infrastructure, defense, education, healthcare, etc. for the growth and welfare of the country.

This area studies the objectives and classification of public expenditure, effects of expenditure in different areas, effects of public expenditure on various factors such as employment, production, growth, etc.

- **Public Debt**

When public expenditure exceeds public income, the gap is filled by borrowing money from the public, or from other countries or world organizations such as The World Bank. These borrowed funds are public debt. This area of public finance explains the burden of public debt, why it is necessary and its effect on the economy. It also suggests methods to manage public debt.

Financial Administration

As the name suggests this area of public finance is all about the administration of all public finance i.e. public income, public expenditure, and public debt. Financial administration includes preparation, passing, and implementation of government budget and various government policies. It also studies the policy impact on the social-economic environment, inter-governmental relationships, foreign relationships, etc.

Importance of Public Finance

1. Steady state economic growth

Government finance is important to achieve sustainable high economic growth rate. The government uses the fiscal tools in order to bring increase in both aggregate demand and aggregate supply. The tools are taxes, public debt, and public expenditure and so on.

2. Price stability

The government uses the public finance in order to overcome form inflation and deflation. During inflation, it reduces the indirect taxes and genera expenditures but increases direct taxes and capital expenditure. It collects internal public debt and mobilizes for investment. In case of deflation, the policy is just reversed.

3.Economic stability

The government uses the fiscal tools to stabilize the economy. During prosperity, the government imposes more tax and raises the internal public debt. The amount is used to repay foreign debt and invention. The internal expenditures are reduced. During recession, the case is just reversed.

4. Equitable distribution

The government uses the revenues and expenditures of itself in order to reduce inequality. If there is high disparity it imposes more taxes on income, profit and properties of rich people and on the goods they consume. The money collected is used for the benefit of poor people through subsidies, allowance, and other types of direct and indirect benefits to them.

5. Proper allocation of resources

The Government finance is important for proper utilization of natural, man made and human resources. For it, on the production and sales of less desirable goods, the government imposes more taxes and provides subsidies or imposes taxes lightly on more desirable goods**.**

6. Balanced development

The government uses the revenues and expenditures in order to erase the gap between urban and rural and agricultural and industrial sectors. For it, the government allocates the budget for infrastructural development in rural areas and direct economic benefits to the rural people.

7. Promotion of Export

The government promotes the export imposing less tax or exempting from the taxes or providing subsidies to the export oriented goods. It may supply the inputs at the subsidized prices. It imposes more taxes on imports and so on.

8. Infrastructural development

The Government collects revenues and spends for the construction of infrastructures. It has to keep peace, justice and security too. It has to bring socio-economic reformation too. For all these things it uses the revenues and expenditures as fiscal tools.

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