CBSE Class–12 Economics

Macro Economics

Chapter 2 – National Income Accounting

Revision Notes

Goods: In economics a goods is defined as any physical object, man made, that could command a price in the market and these are the materials that satisfy human wants and provide utility

Consumption Goods: Those final goods which satisfy human wants directly.
E.g.: ice-cream and milk used by the households.

Capital Goods: Those final goods which help in production. These goods are used for generating income. These goods are fixed assets of the producers. Ex- plant and machinery.

Final Goods are those goods which are used either for final consumption or for investment.

Intermediate Goods refers to those goods and services which are used as a raw material for further production or for resale in the same year.

These goods do not fulfil needs of mankind directly.

Investment: Addition made to the physical stock of capital during a period of time is called investment. It is also called capital formation.

Capital formation: - Change in the stock of capital is also called capital formation.

Depreciation: It means fall in value of fixed capital goods due to normal wear and tear and expected obsolescence. It is also called consumption of fixed capital.

Gross Investment: Total addition made to physical stock of capital during a period of time. It includes depreciation. OR <u>Net Investment + Depreciation</u>

Net Investment: Net addition made to the real stock of capital during a period of time. It excludes depreciation.
Net Investment = Gross investment – Depreciation

Stocks: Variables whose magnitude is measured at a particular point of time are called stock variables. E.g. National Wealth, Inventory etc.

Flows: Variables whose magnitude is measured over a period of time are called flow variable. E.g. National income, change in stock etc.

Circular flow of income: It refers to continuous flow of goods and services and money income among different sectors in the economy. It is circular in nature. It has neither any end and nor any beginning point. It helps to know the functioning of the economy.

Leakage: It is the amount of money which is withdrawn from circular flow of income. For e.g. Taxes, Savings and Import. It reduces aggregate demand and the level of income.
Injection: It is the amount of money which is added to the circular flow of income. For e.g. Govt. Exp., investment and exports. It increases the aggregate demand and the level of income.

Economic Territory: Economic (or domestic) Territory is the geographical territory administrated by a Government within which persons, goods, and capital circulate freely.

Scope of Economic Territory:

(a) Political frontiers including territorial waters and airspace.
(b) Embassies, consulates, military bases etc. located abroad.
(c) Ships and aircraft operated by the residents between two or more countries.
(d) Fishing vessels, oil and natural gas rigs operated by residents in the international waters.

Normal Resident of a country: is a person or an institution who normally resides in a country and whose Centre of economic interest lies in that country.

Exceptions: -

(a) Diplomats and officials of foreign embassy.
(b) Commercial travellers, tourist's students etc.
(c) People working in international organizations like WHO, IMF, UNESCO etc. are treated as normal residents of the country to which they belong.

The related aggregates of national income are:-

(i) Gross Domestic Product at Market price (GDP_{MP})

(ii) Gross Domestic Product at Factor Cost (GDP_{FC})

(iii) Net Domestic Product at Market Price (NDP_{MP})

(iv) Net Domestic Product at FC or (NDP_{FC})

(v) Net National Product at FC or National Income (NNP_{FC})

(vi) Gross National Product at FC (GNP_{FC})

(vii) Net National. Product at MP (NNP_{MP})

(viii) Gross National Product at MP (GNP_{MP})

(i) Gross Domestic Product at Market Price: It is the money value of all the final goods and services produced within the domestic territory of a country during an accounting year.

GDP_{MP} = Net domestic product at FC (NDP_{FC}) + Depreciation + Net Indirect tax.

(ii) Gross Domestic Product at FC: It is the value of all final goods and services produced within domestic territory of a country which does not include net indirect tax.

GDP_{FC} = GDP_{MP} – Indirect tax + Subsidy or GDP_{FC} =
GDP_{MP} – NIT

(iii) Net Domestic Product at Market Price: It is the money value of all final goods and services produced within domestic territory of a country during an accounting year and does not include depreciation.

NDP_{MP} = GDP_{MP} – Depreciation

(iv) Net Domestic Product at FC: It is the value of all final goods and services which does not include depreciation charges and net indirect tax. Thus it is equal to the sum of all factor incomes (compensation of employees, rent, interest, profit and mixed income of self-employed) generated in the domestic territory of the country.

NDP_{FC} = GDP_{MP} – Depreciation – Indirect tax + Subsidy

(v) Net National Product at FC (National Income) : It is the sum total of factor incomes (compensation of employees + rent + interest + profit) earned by normal residents of a country in an accounting year

or

NNP_{FC} = NDP_{FC} + Factor income earned by normal residents from abroad - factor payments made to abroad.

(vi) Gross National Product at FC: It is the sum total of factor incomes earned by normal residents of a country along with depreciation, during an accounting year.

GNP_{FC} = NNP_{FC} + Depreciation OR
GNP_{FC} = GDP_{FC} + NFIA

(vii) Net National Product at MP: It is the sum total of factor incomes earned by the normal residents of a country during an accounting year including net indirect taxes.

NNP_{MP} = NNP_{FC} + Indirect tax – Subsidy

(viii) Gross National Product at MP: It is the sum total of factor incomes earned by normal residents of a country during an accounting year including depreciation and net indirect taxes.

GNP_{MP} = NNP_{FC} + Dep + NIT

Domestic Aggregates

Gross domestic Product at Market Price GDP_{MP} is the market value of all the final goods and services produced by all producing units located in the domestic territory of a country during an accounting year. It includes the value of depreciation or consumption of fixed capital.

Net Domestic Product at Market Price $\left(NDP_{MP}\right)$:$NDP_{MP} = GDP_{MP}$ -Depreciation (consumption of Fixed capital). It is the market value of final goods and services produced within the domestic territory of the country during a year exclusive of depreciation.

Domestic Income $\left(NDP_{FC} \right)$**:** It is the factor income accruing to owners of factors of production for suppling factor services with in domestic territory during an accounting year.

NATIONAL AGGREGATES

Gross National Product at Market Price (GNP_{MP}) is the market value of all the final goods and services produced by normal residents (in the domestic territory and abroad) of a country during an accounting year.

$GDP_{MP} + NFIA = GNP_{MP}\left(MNP_{FC}\right)$

National Income NNP_{FC}

It is the sum total of all factors incomes which are earned by normal residents of a country in the form of wages. Rent, interest and profit during an accounting year.

$$NNP_{FC} = NDP_{FC} + NFIA = National\ Income$$