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National Income Accounting

By:

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Price

₹ 200/-

Published by:

NEERAJ PUBLICATIONS

Admn. Office : **Delhi-110007**
Sales Office : **1507, 1st Floor, Nai Sarak, Delhi-110 006**
E-mail: **info@neerajignoubooks.com** *Website*: **www.neerajignoubooks.com**

Reprint Edition	Typesetting by: Competent Computers	Printed at: Novelty Printer

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NATIONAL INCOME ACCOUNTING

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Sample Preview of the Solved Sample Question Papers

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QUESTION PAPER

(June – 2018)

(Solved)

NATIONAL INCOME ACCOUNTING

Time: 3 Hours] *[Maximum Marks: 100%*
(Weightage: 70%)

Note: *Attempt questions from each section as per instructions given under each section.*

SECTION – A

Q. 1. Explain value added technique of estimating national income. Using suitable examples, indicate the sector in which value added method is mainly used.

Ans. Ref.: See Chapter-4, Page No. 18, 'Production (or Value Added) Method', Page No. 20, 'Choice of Method' and Page No. 19, 'National Income and 'Steps in Estimation'.

Q. 2. What do you understand by environmental accounting? What are its main objectives? What are the main approaches to environmental accounting?

Ans. Environmental Accounting is a field that identifies resources use, measures and communicates cost of a company's or national economic impact on the environment. It is a subset of accounting and its target is to incorporate both economic and environmental information.

Also Add: Ref.: Chapter-23, Page No. 120, 'Objectives of Enviromental Account' and 'Approaches to Environmental Account'.

Q. 3. What is economic welfare? How do you measure it? How does Human Development Index help in measuring economic welfare?

Ans. Economic welfare is the level of prosperity and quality of living standards in an economy. It can be measured through a variety of factors such as GDP and other indicators which reflect welfare of the population such as literacy, number of doctors, level of pollution, etc. It is a general concept which refers to how well people are doing or how happy they are.

Also Add: Ref.: Chapter-22, Page No. 112, 'What of HDI', 'Significance of HDI' and 'Method of Construction of HDI'.

Q. 4. What is the importance of services in economic development? How would you estimate contributions of banking and insurance to GDP in India?

Ans. Ref.: See Chapter-20, Page No. 99, 'Role of Services', 'Variety of Services', Page No. 101, 'Importance of Services in Economic Development' and Page No. 100, 'Banking and Insurance'.

SECTION-B

Q. 5. What is investment? How do you measure investment? Differentiate between gross and net investment.

Ans. In an economy, we can use the terms investment and capital formation interchangeably as they have same meaning.

Investment reflects the national product which was used for increasing productivity in a country and not for consumption purpose. e.g. new factories, construction of rails, roads, etc. are all types of investments. Thus, in national income accounting, capital formation is defined as excess of production over consumption during a given accounting year.

Investment is the addition made to capital during a given period. Capital is a stock concept and capital formation is a flow concept. e.g. the capital stock at the end of March 2000 was Rs. 1500 crore and at the end of March 2001 was Rs. 2000 crore. Then the investment or capital formation during the year was only 500 crore.

Capital formation during a year = Capital at the end of year–Capital at the beginning of the year

Investment may be either a choice or just because no other option is there. Or we sometime invest deliberately and sometimes because of compulsion or necessity. Say, machinery in the company got obsolete then we have to invest in its repair or to purchase new machinery. Mostly, investment in fixed asset is deliberate and planned in advance whereas investment in stock may be partly deliberate or partly compulsion. Both planned and unplanned additions in capital good during a year are investment.

Also Add: Ref: See Chapter-12, Page No. 62, 'Gross *Vs.* Net Investment'.

Q. 6. Define disposable income. How do you compute Gross National disposable income?

Ans. Ref.: See Chapter-5, Page No. 23, 'Concepts of Disposable Income' and Page No. 23-24, 'Concept of Adjusted Disposable Income'.

Q. 7. What are the various sources of data for national income in primary and tertiary sectors of India?

Ans. Ref.: See Chapter-17, Page No. 87, 'Primary Sector' and Page No. 89, 'Tertiary Sectors'.

Q. 8. Explain the concept of Physical Quality of Life Index (PQLI). Evaluate the effectiveness of this index as a measure of development.

Ans. Ref.: See Chapter-22, Page No. 115, Q. No. 2, 3 and 9 and Page No.111, 'Evaluation'.

Q. 9. What difficulties are encountered in India while estimating national income?

Ans. The major difficulties faced by India during computation of national income are:

***(i)* Types of Goods and Services:** Goods and Services having money value are included in the national income but there are goods and services which may have no corresponding flow of money payments.

***(ii)* Problems of Double Counting:** Double counting implies the possibility of a commodity like raw material or labour being included in national income more than once, e.g. a farmer sells maize worth rupees two hundred to a millowner who further sells maize flour to whole sale dealer. The money value increases in this case but actual national income remains same.

***(iii)* Excluded Market Transactions:** Certain transactions that take place in the market are excluded from the computation of national income because they violate the general rule for the recognition of income. Many transactions are such that represent merely the transfer of wealth or the exchange of commodities produced in some previous accounting periods.

***(iv)* Problem of Imputed Values:** There are certain goods and services which do not appear in or cannot be brought to the market. In such cases, we have to impute values to them. The task of imputing or fixing values is not easy.

***(v)* Inventory Adjustment:** Changes in the stock of capital goods or final products are also to be taken into account while computing national income. The difference between the officially published figures and figures obtained from the business accounting data calls for inventory valuation adjustment.

Q. 10. Describe the expenditure method of estimating national income in India.

Ans. Ref.: See Chapter-4, Page No. 19-20, 'Expenditure Method'.

SECTION-C

Q. 11. Explain the following concepts:

***(a)* Transfer Payments**

Ans. One-way payment of money for which no money, good, or service is received in exchange. Governments use such payments as means of income redistribution by giving out money under social welfare programs such as social security, old age or disability pensions, student grants, unemployment compensation, etc. Subsidies paid to exporters, farmers, manufacturers, however, are not considered transfer payments. Transfer payments are excluded in computing gross national product.

***(b)* Public Enterprises**

Ans. Public Enterprises: Public enterprises are business organizations wholly or partly owned by the state and controlled through a public authority. Public enterprises as a form of business organization gained importance in recent time. It is an industrial or commercial undertaking which is owned and managed by central, state or local government and of which, the output is marketed. Public enterprises consist of manufacturing, trading as-well-as service organizations which are essentially business undertakings. The objectives of public enterprises are laid down with the objectives of development plans.

***(c)* Registered Manufacturing**

Ans. Ref.: See Chapter-16, Page No. 83, 'Registered Manufacturing'.

***(d)* Intermediate Goods**

Ans. Ref.: See Chapter-3, Page No. 15, Q. No. 5.

***(e)* Non-financial Flows**

Ans. Ref.: See Chapter-11, Page No. 60, Q. No. 9 (Non-Financial Flows).

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Sample Preview
of
The Chapter

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NATIONAL INCOME ACCOUNTING

INTRODUCTION TO NATIONAL INCOME ACCOUNTING

National Income and the Economy

1

INTRODUCTION

In this chapter, we are going to discuss about the National Income of an economy. After reading this chapter, we also try to answer questions like why we need to know national income? What national income indicates? To answer these we need to know about the concepts of National Income.

CHAPTER AT A GLANCE

MEANING OF AN ECONOMY

A.G. Brown has defined an economy as "a system by which people get their living."

In simple words, an economy of a country can be defined as collection of economic activities of a country, i.e. production, consumption and distribution, undertaken by its citizens.

Production activities comprises of producing both goods and services. e.g. work carried out in farm, factories, bank etc. consumption activities can be classified into two:

1. By Households: To satisfy the wants people spend money on food, house, clothing etc.

2. By Government: The main motive is to spend for people. Government usually spends on defence facilities, infrastructure development etc.

While production, investment needs to be done in raw material, stock, machinery etc. so that production can be carried out smoothly. Investment is the amount that adds to capital assets.

There are two types of economy: Open economy and closed economy. An open economy is an economy in which there are economic activities between domestic country and other countries, e.g. people, can trade in goods and services with other people in the world. In a closed economy there is no trade with other countries. The trade and finance of a country is confined only to its boundary.

MEANING OF NATIONAL INCOME

National income can be defined in terms of activities performed by an economy.

From production point of view, "National income is the sum of money value of net flow of all the final goods and services produced by normal residents of a country during a period of account."

From income point of view, "National income is the sum of factor incomes earned by normal residents of a country in the form of rent, wages, interest and profit in an accounting year."

From expenditure point of view, "National product is the net output of commodities and services flowing during the year from the country's productive system into the hands of ultimate consumers or into the net addition to the capital goods."

One point which needs to be kept in mind is that national income calculated by these three methods is same.

Here a resident means the person whose economic interest lies in the country. Factor incomes are the incomes earned by owners of factors (used in production) for rendering their products or services for production. e.g. owner of land get rent, capital get interest etc.

Now, production can be classified further into three sectors: primary, secondary and tertiary sectors.

Investment can be classified into domestic and foreign investment and consumption can be divided into household and government.

QUESTIONS ABOUT AN ECONOMY THAT INTEREST US

As a citizen of a country we want to know about the performance of our country, how much it is growing compared to past and other countries, about standard of living etc. the answers to all these can be made only after looking at data. Few questions which interest us as an student of economics about an economy and which can be answered by study of national income are as follows:

1. Is the economy growing?
2. Are all parts of the economy growing?
3. Are people getting more goods and services?
4. Are all sections of the people benefitting from growth?
5. Is the standard of living of the people rising?
6. What is the future of the economy?
7. How rich or poor is the economy in comparison to other economies of the world?
8. Is government spending enough on welfare activities?
9. How should funds be allocated?

Is the Economy Growing?

The rate of growth of economy is nothing but the rate of growth of national income. So, next time when you hear that Indian economy's growth rate was 7% last year, you should understand that it is the growth in national income of India as compared to base prices.

Rate of growth can be calculated by dividing the change in national income at constant prices by national income at constant prices during the previous year multiplied by 100.

Now what is constant price? If goods and services produced in a year are valued at fixed prices, i.e. prices of the base year, it is called national income at constant prices.

Are All Parts of the Economy Growing?

An economy can be categorized on the basis of occupation into three:

(i) **Primary sector:** It consists of units producing goods by changing or modifying the natural resources directly. e.g. farming, fishing etc.

(ii) **Secondary sector:** This sector transfers one good into another. e.g. production of car, machinery etc.

(iii) **Tertiary sector:** This comprises of production of services. e.g. banks, insurance, government department etc.

The contribution of all the sectors in growth of economy is essential since they are interdependent. The growth of one sector depends on the other. Suppose there is a slowdown in agriculture sector, then there will be a corresponding slowdown in production sector which use agricultural product as raw material. Therefore, government is always curious to know the individual growth of these sectors.

Are People Getting More Goods and Services?

"*Dil Maange More*", a very famous caption of a soft drink actually tells the psychology of human beings. As an individual more is preferred to less. A country wants its people to have more of goods and services every year. This can be measured by per capita income. It measures the average availability of goods and services to each individual during a given period. So, if per capita income raises it means that national income of the country is growing. But vice versa is not true. This happened in case of India in 1976-77 that although there was rise in national income by .9% the per capita income fell by 1.3%. This happened because population growth rate was much higher at rate of 2.2%.

Is Growth Benefiting All Sections of the Population?

Being a country for people, government cannot afford to neglect a section of society in pursuit of development. Each section, whether rural or urban, whether labour class or business class needs to be considered while taking any action. Therefore it's necessary for government to see that is the growth of country is equally distributed or not. If its not, then government will try to take some action to make it equal.

Is the Standard of Living of the People Rising?

Had you seen the new car she had bought? Her wardrobe is full of designer clothes. These are some statements which we generally discuss in our day-to-day life. This shows how interested we are in general standard of living.

Standard of living of a family can be determined by what family spends on satisfaction of wants. In same way standard of living of a country is depends on spending on consumer goods and services. An increase in per capita consumption expenditure shows that the standard of living rises. National income calculated by expenditure method is relevant for this section. As we divide expenditure into consumption expenditure and investment expenditure.

What is the Future of the Economy?

As an individual, we usually save out of our current income and invest in financial instruments to make our future secure. Similarly, a country as a whole saves and invests. The investment is done to make more goods and services in future. More the investment, more flow of goods in future, probably much higher standard of living of society in future. Investment within economic territory of the country is termed as Domestic Capital Formation. Investment outside the country is termed net exports. Both of these investments together determine the future of society.

How Rich or Poor is the Economy?

Such question of relativity can be answered by comparing the national incomes of different countries with our national income. By comparing economies, we can say how rich or poor our country is in relation to foreign countries. e.g. the per capita income of India and USA in the year 1994 were 320 and 25880 US dollars respectively. The comparison of these figures show that an American was 80 times richer than an Indian. However this comparison is vague.

This comparison of national incomes is useful in international project. The expenditure on this project can be shared among countries according to the income levels.

Is Government Spending Enough on Welfare Activities?

The core functions of every government is to maintain law and order, provide basic amenities to citizens, health facilities, good roads, water supply etc. For these activities government incurs expenditure on hospitals, infrastructure, schools etc. More the expenditure more is the facilities. The data can be collected from expenditure method of estimating national income. This variable is called Government Final Consumption Expenditure.

How Should Funds be Allocated?

The decision of allocation of funds is taken by Planning Commission, or any other body appointed by government. It's not only how much to allocate to one sector and the other, but something more important is needed to be considered. The dependence of the sectors among each other is also need to be understood. While allocating funds to agricultural sector its dependence on producers of chemical fertilizers, water pumps, and pesticides etc. must be also taken care of. Supporting funds are needed to be allocated to these depending sectors also so that the targets can be achieved. For allocating funds it is necessary to know two things–from whom the sector buys inputs and to whom the sector sells outputs. The data is summarized in an account called input-output accounting matrix which is prepared from the data used in estimation of national income.

CHECK YOUR PROGRESS

Q. 1. What do you understand by "resident" in the context of an economy?

Ans. By resident, we mean the people whose economic interest lies within the country where they reside. Economic interest means the economic activities performed by economy: production, consumption and distribution. It also includes the people who although do not live in that country but their economic interest lies in that country.

Q. 2. Explain the four factors of production and the respective payments made to them.

Ans. The four major factors of production are: land, labour, capital and entrepreneur. These factors are provided by their owners to the production units to perform production activity. In return of the factor services, production units pay rent, wages, interest and profit respectively to the owners of factors of production. The sum total of all the factor incomes is the national income of the country.

Q. 3. What information can be revealed from expenditure method of estimating national income?

Ans. Expenditure method reveals the expenditure incurred by each sector. It is also useful to know the standard of living of the people, whether it is rising or not. The total expenditure of the country could be classified as consumption expenditure and investment expenditure. Private consumption and government expenditure both reflects the spending behaviour of the country and reflects the status of living enjoyed by its people. Expenditure approach is also useful in making the policy of future. The approach provides data on saving and investment which actually determines the future of the economy. More the investment and saving then more will be the growth in future.

Q. 4. How do we know that on an average people are getting more goods and services every year?

Ans. We can calculate the amount of goods and services an average person gets by calculating Per Capita Income. It is equal to total number of goods and services produced in a year divided by total population of the country. The estimate calculated will be the average of goods and services an individual has. e.g. if total number of products produced is 20000 and the population amounts to 100, then the per capita income will be 20000/100 which is equal to 200.

Q. 5. How do you know from national income data that government is spending enough on welfare of the people?

Ans. One can know about the government spending by studying the national income accounts. It is more clearly given when we calculate the estimates on the basis of expenditure method. In this method, expenditure incurred on goods and services produced within the territory is calculated. This expenditure method classifies the expenditure in two: expenditure incurred by household and expenditure incurred by government. The government spends money for the welfare of people only. To provide facilities and basic necessities to its citizens government spends. This expenditure is called government final consumption expenditure. If the share of government expenditure in national income is more it means that government is spending more on welfare of people and vice-versa.

Q. 6. How is national income data helpful in allocation of funds among different industrial sectors?

Ans. National income data provides the sector-wise distribution of national income. It helps the Planning Commission (or the organization formulating plans) to allocate sector-wise funds. What is important is the study of interdependence of the sectors. As the sectors have backward and forward linkages with other sectors, boom or recession in one sector will probably affect other sectors too. So, while deciding about the amount of fund to be allocated to a particular sector, the committee will also provide appropriate funds to its interlinked sectors so that the growth does not hamper.

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