GENERAL STUDIES

Indian Economy

For

UPSC /KPSC-CIVIL SERVICES

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INDIAN ECONOMY

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UNIT 1

NATIONAL INCOME

Economic Growth

Economic growth is the change, increase or decrease in the value of goods and services produced by an economy.

National income can be defined as the total value of a country's final output of all new goods and services produced in one year.

National Income Accounting

National income accounting is a bookkeeping system that a government uses to measure the level of the country's economic activity in a given time period. Accounting records of this nature include data regarding total revenues earned by domestic corporations, wages paid to foreign and domestic workers, and the amount spent on sales and income taxes by corporations and individuals residing in the country.

Although national income accounting is not an exact science, it provides useful insight into how well an economy is functioning, and where monies are being generated and spent. When combined with information regarding the associated population, data regarding per capita income and growth can be examined over a period of time.

Some of the metrics calculated by using national income accounting include gross domestic product (GDP), gross national product (GNP) and gross national income (GNI). The GDP is a widely used for economic analysis on the domestic level and represents the total market value of the goods and service produced within a specific nation over a selected period of time.

The Importance of National Income

Measuring national income is crucial for various purposes:

1. The measurement of the size of the economy and level of country's economic performance;
2. To trace the trend or the speed of the economic growth in relation to previous year(s) also in other countries;
3. To know the composition and structure of the national income in terms of various sectors and the periodical variations in them.
4. To make projections about the future development trend of the economy.
5. To help government formulate suitable development plans and policies to increase growth rates.
6. To make international comparison of people's living standards.

Measuring economic Growth in India

Measures of national income are used in economics to estimate the value of goods and services produces in a country. Common measures are Gross domestic Product (GDP) and Gross national product (GNP)

Thenew series of national income was started in 2015 by Ministry of Statistics and programme implementation, Govt. Of India, with new base year 2011-12.

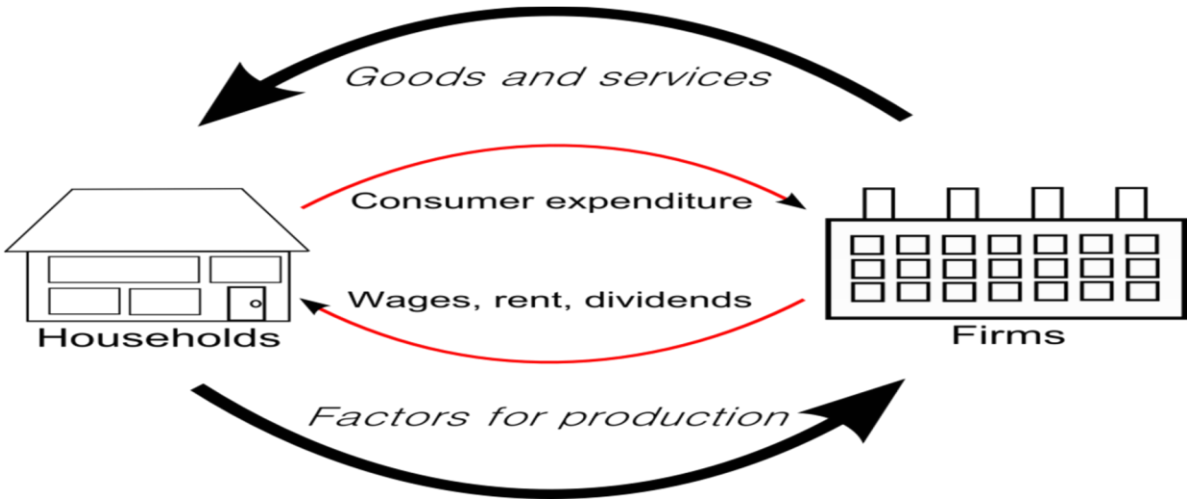
In old series GDP at factor cost was called GDP but in new series GDP at market prices is called GDP. Estimates of GVA at factor cost are earlier called as GDP at factor cost. There are various measure of national income with respect to different perspectives. They are similar to one another and is represented in the following figure.

Methods of Measuring National Income

There are various estimates in measuring national income with respect to different perspectives.There are four players who contribute to national income. They are individuals or households, investors, government and foreign nationals.

The below circular figure shows the interaction between the four players. The upper part shows the demand side of economy and the lower part shows the supply side of economy.

In the lower part households supply factors of production viz land, labour,capital and entrepreneur to business firms to produce goods and services. In return the business firms give rent, wage, interest and profit to land, labour, capital and entrepreneur respectively.



1. The Income Method:

The rent, wage, interest, profit are expenditure to firms but income to households. So it is evident that expenditure of one player is income to another. Hence, national income can be calculated by compiling income or expenditure of all. The calculation by compiling income is called as income method.

2. The Product Method:

This is also known as the **value added method**or **output method** or **production method**. In this method we calculate the aggregate annual value of goods and services produced in a given period of time.

3. Expenditure Method:

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

Gross value added at basic prices It is also called as GVA at producers' prices. It is different from market prices or buyers prices. The producers prices is equivalent to production cost. The GVA is arrived from output of industries. Output consists of input material and services which is known as intermediate consumption and the value addition made to input material and services to bring it as final goods and services.

Output = Input materials and services + value added

GVA at basic prices = output - Intermediate Consumption

So to arrive at GVA the intermediate consumption is deducted from output value. For example, wheat flour is the final product of manufacturing industries. Let the value of 1 kg of wheat flour at basic price is Rs.80. So the the value of final output is Rs.80. To manufacture wheat flour the inputs are wheat (value Rs.30) and electricity (value Rs.10) {Intermediate consumption = (10+30)}

80 (value of final output)**- 30 (**Intermediate Consumption) = **50 (GVA at basic price)**

Gross value added at factor cost

Gross value added at factor cost can be derived from gross value added at basic prices by subtracting other taxes on production and adding subsidies on production.

GVA at Factor cost = output - (intermediate consumption) - production taxes - production subsidies)
GVA at Factor cost = GVA at basic prices - (Production Taxes- Production subsidies)

- Production taxes/subsidies are independent of the quantity (volume) of production.(Eg: tax — land revenues, stamps fees, registration fees, tax on the profession; subsidies — subsidies to Railways, input subsidies to farmers, subsidies to the village and small industries, administrative subsidies to corporations or cooperatives, etc.).

PRODUCTION METHOD

1. Gross domestic product (GDP)

GDP is defines as the total market value of all final goods and services produced within the country in a given period of time.

It is nothing but sum of the factor costs incurred during the process of turning out economy's output for the concerned year. Thus, it is a compilation of wages, interests salaries, profits etc.

GDP = GVA at basic prices + (Product taxes including import duties - Product subsidies)
Product taxes or subsidies are paid or received on per unit of product. Some examples are:

Product Taxes: Excise Tax, Sales tax, Service Tax and Import and Export duties etc.

Product Subsidies: Food, Petroleum and fertilizer subsidies, Interest subsidies given to farmers, households etc through banks, Subsidies for providing insurance to households at lower rates etc. **GDP by expenditure method includes:**

(1) Consumer expenditure on services and durable and non-durable goods (C),

(2) Investment in fixed capital such as residential and non-residential building, machinery, and inventories (I),

(3) Government expenditure on final goods and services (G),

(4) Export of goods and services produced by the people of country (X),

(5) Less imports (M). That part of consumption, investment and government expenditure which is spent on imports is subtracted from GDP. Similarly, any imported component, such as raw materials, which is used in the manufacture of export goods, is also excluded.

Thus GDP by expenditure method at market prices = C+ I + G + (X – M), where (X-M) is net export which can be positive or negative.

2. Gross national product (GNP)

Gross national product (GNP) is an estimate of total value of all the final products and services turned out in a given period by the means of production **owned by a country's residents.** GNP is commonly calculated by taking the sum of personal consumption expenditures, private domestic investment, government expenditure, net exports and any income earned by residents from overseas investments, minus income earned within the domestic economy by foreign residents. Net exports represent the difference between what a country exports minus any imports of goods and services.

GNP = Consumption + investment + government expenditure + net exports + income earned by residents from overseas investments - income earned within the domestic economy by foreign residents.

GNP = GDP + Net factor income from abroad

GNP and GDP

GNP and GDP are very closely related concepts, and the main difference is that GNP includes net foreign income (what foreigners produce in the country is subtracted from what Indians produce abroad) .

GDP is a geographical concept which includes all domestic production , disregarding the producing entities nationalities. GNP is about who produces.

For example, there are Indian and foreign firms operating in India. The profits of foreign firms earned within India is calculated under India's GDP, but not in India's GNP.

For example, Greece, which is going through a long-running financial problem owing to a debt crisis, has higher GNP than GDP. This indicates its citizens producing and contributing more through their overseas operations - a net addition contributing to the higher GNP. Amid the economic crisis in Greece, not many foreigners may be operating in a country which may limit its GDP.

Other nations like China, the U.K., India, and Israel have lower GNP compared to corresponding GDP figures. This indicates these nations are seeing a net overall outflow from the country. Citizens and

businesses of these countries operating overseas are generating lesser income compared to the income generated by the foreign citizens and businesses operating in these countries.

3. Net domestic product (NDP)

The net domestic product (NDP) is an annual measure of the economic output of a nation that is adjusted to account for depreciation, calculated by subtracting depreciation from the gross domestic product (GDP).Net domestic product accounts for capital that has been consumed over the year in the form of housing, vehicle, or machinery deterioration. The depreciation accounted for is often referred to as capital consumption allowance and represents the amount needed in order to replace those depreciated assets.