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CLASS: XII ECONOMICS

National Income Accounting

National income accounting is a term that refers to measuring the health of an economy, the economic activity, and the forecasted growth and development during a particular time period. Activities such as domestic revenue, wages to foreign and domestic employees, sales, and income taxes are all included. In simple terms, it measures the aggregate (total) output as well as the aggregate income in an economy. Using national income accounting gives us a look at how the economy is performing and where money is being earned and spent.

Main Uses of National Income Accounting:

These are as under:

(i) It indicates performance of the economy signifying economy's strength and failures.

(ii) It helps to find out structural changes in the economy For instance, in India, proportional share of primary (agricultural) sector in national income is declining whereas those of secondary (industrial) sector and tertiary (services) sector are rising.

(iii) It reflects how national income is shared among various factors of production. In this context, it is especially helpful to trade unions in making rational analysis of remuneration that the labour is getting.

(iv) It helps in making comparison among nations in respect of national income and per capita income which lead us to make suitable changes in plans and approaches to achieve rapid economic development.

(v) National income statistical data reflect the specific contribution of individual sectors and their growth over time

Private Income:

Private income is income obtained by private individuals from any source, productive or otherwise, and the retained income of corporations. It can be arrived at from NNP at Factor Cost by making certain additions and deductions.

The additions include transfer payments such as pensions, unemployment allowances, sickness and other social security benefits, gifts and remittances from abroad, windfall gains from lotteries or from horse racing, and interest on public debt. The deductions include income from government departments as well as surpluses from public undertakings, and employees' contribution to social security schemes like provident funds, life insurance, etc.

Thus Private Income = National Income (or NNP at Factor Cost) + Transfer Payments + Interest on Public Debt — Social Security — Profits and Surpluses of Public Undertakings.

Personal Income:

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in one year. Personal income is never equal to the national income, because the former includes the transfer payments whereas they are not included in national income.

Personal income is derived from national income by deducting undistributed corporate profits, profit taxes, and employees' contributions to social security schemes. These three components are excluded from national income because they do reach individuals.

But business and government transfer payments, and transfer payments from abroad in the form of gifts and remittances, windfall gains, and interest on public debt which are a source of income for individuals are added to national income. Thus Personal Income = National Income – Undistributed Corporate Profits – Profit Taxes – Social Security Contribution + Transfer Payments + Interest on Public Debt.

Personal income differs from private income in that it is less than the latter because it excludes undistributed corporate profits.

Thus Personal Income = Private Income – Undistributed Corporate Profits – Profit Taxes.

Disposable Income:

Disposable income or personal disposable income means the actual income which can be spent on consumption by individuals and families. The whole of the personal income cannot be spent on consumption, because it is the income that accrues before direct taxes have actually been paid. Therefore, in order to obtain disposable income, direct taxes are deducted from personal income. Thus Disposable Income=Personal Income – Direct Taxes.

But the whole of disposable income is not spent on consumption and a part of it is saved. Therefore, disposable income is divided into consumption expenditure and savings. Thus Disposable Income = Consumption Expenditure + Savings.

If disposable income is to be deduced from national income, we deduct indirect taxes plus subsidies, direct taxes on personal and on business, social security payments, undistributed corporate profits or business savings from it and add transfer payments and net income from abroad to it.

Thus Disposable Income = National Income – Business Savings – Indirect Taxes + Subsidies – Direct Taxes on Persons – Direct Taxes on Business – Social Security Payments + Transfer Payments + Net Income from abroad.

Real Income:

Real income is national income expressed in terms of a general level of prices of a particular year taken as base. National income is the value of goods and services produced as expressed in terms of money at current prices. But it does not indicate the real state of the economy.

It is possible that the net national product of goods and services this year might have been less than that of the last year, but owing to an increase in prices, NNP might be higher this year. On the contrary, it is also possible that NNP might have increased but the price level might have fallen, as a result national income would appear to be less than that of the last year. In both the situations, the national income does not depict the real state of the country. To rectify such a mistake, the concept of real income has been evolved.

In order to find out the real income of a country, a particular year is taken as the base year when the general price level is neither too high nor too low and the price level for that year is assumed to be 100. Now the general level of prices of the given year for which the national income (real) is to be determined is assessed in accordance with the prices of the base year. For this purpose the following formula is employed.

Real NNP = NNP for the Current Year x Base Year Index (=100) / Current Year Index

Suppose 1990-91 is the base year and the national income for 1999-2000 is Rs. 20,000 crores and the index number for this year is 250. Hence, Real National Income for 1999-2000 will be = 20000 x 100/250 = Rs. 8000 crores. This is also known as national income at constant prices.

Different Types of Money :

There are 4 major types of Money :

- **Commodity Money**
- **Fiat Money**
- **Fiduciary Money**
- **Commercial Bank Money**

Commodity Money

It is the simplest kind of money which is used in barter system where the valuable resources fulfill the functions of money. The value of this kind of money comes from the value of resource used for the purpose. It is only limited by the scarcity of the resources. Value of this kind of money involves the parties associated with the exchange process. These money have intrinsic value.
Ex : gold coins , beads , shells, pearls, stones, tea, sugar, metal

Fiat Money

The word fiat means the"command of the sovereign". Fiat currency is the kind of money which don't have any intrinsic value and it can't converted into valuable resource. The value of fiat money is determined by government order which makes it a legal instrument for all transaction purposes. The fiat money need to be controlled as it may affect entire economy of a country if it is misused. Today Fiat money is the basis of all the modern money system. The real value of fiat money is determined by the market forces of demand and supply.
Ex : Paper money, Coins

Fiduciary Money

Today's monetary system is highly fiduciary. Whenever, any bank assures the customers to pay in different types of money and when the customer can sell the promise or transfer it to somebody else, it is called the fiduciary money. Fiduciary money is generally paid in gold, silver or paper money. There are cheques and bank notes, which are the examples of fiduciary money because both are some kind of token which are used as money and carry the same value.

Commercial Bank Money

Commercial Bank money or demand deposits are claims against financial institutions that can be used for the purchase of goods and services. A demand deposit account is an account from which funds can be withdrawn at any time by cheque or cash withdrawal without giving the bank or financial institution any prior notice. Banks have the legal obligation to return funds held in demand deposits immediately upon demand (or 'at call'). Demand deposit withdrawals can be performed in person, via cheques or bank drafts,using ATMs or through online banking.

Other types of Money :

There are also various other types of money like the credit money, electronic money, coin and paper money, Fractional money and Repesentative money as discussed below :

Fractional Money
It is a hybrid type of money which is partly backed by a commodity and has a fiat money transaction purpose. If the commodity loses its value then Fractional money converts into Fiat money.

REPRESENTATIVE MONEY
It represents a claim on commodity and it can be redeemed for that commodity at a bank . It is a token or paper money that can be exchanged for a fixed quantity of commodity. Its value depends on the commodity it backs.

Coins
Metals of particular weight are stamped into coins. There are various precious metals like gold, silver, bronze , copper whose coins are already used in human history. The mintingg of coins is controlled by the state.

Paper Money
Paper money don't have any intrinsic value , as a fiat money it is approved by government order to be treated as legal tender through which value exchange can happen. Governments print the paper money according to the requirements which is tightly controlled as it can affect the economy of the country.

Demand for Money : Your **demand for money** is how much of your wealth you wish to hold as money at any moment in time.

Transactions Motive for Holding Money
The most obvious answer is that we hold some money because it's convenient to buy stuff with. We'll call this first reason the **transactions motive**. Essentially, it's convenient to hold a certain average amount of money at any given time, depending on the kind of purchases you make and the size of your income.

Speculative Motive for Holding Money
Now, in addition to the transactions motive, there is one other reason why people have a demand for holding money balances. This is called the **speculative motive**. Suppose that interest rates fluctuate. At a two percent rate of interest, you would get Rs.1,020 in a year's time in exchange for Rs.1,000 in cash now (i.e. by buying now for Rs.1,000 a bond that pays Rs.1,020 in a year, which is the same thing as lending Rs.1,000 at two percent interest). Suppose that the rate of interest is now two percent, but you expect it to rise to ten percent shortly. At ten percent, Rs.1,000 in cash now will get you Rs.1,100 in a year's time. So if you think interest rates are unusually low and likely to rise, you might keep your wealth as money rather than buying bonds at the low current interest rate.

Interesting facts about various types of money :
- In China cowry shells are regarded as money during 1000 B.C to 1200 B.C.
- Leather bags are treated as money in the ancient city of Carthage.
- Copper coins are treated as money by Romans 600B.C.
- Silver coins are treated as money by Ancient Persians between 600-300 B.C.
- Gold Coins are treated as money in 600 B.C in Anatolia (Asian Turkey or Asia Minor)
- Paper Money first appeared in China about 800 AD . In Europe, Sweden is the First country to issue Paper Money in 1661.