Answer on Question#37424 - Economics-Macroeconomics

Assignment

What are the different methods of calculating national income?

Solution

The national income of a country can be measured by three alternative methods: (i) Product Method (ii) Income Method, and (iii) Expenditure Method.

1. Product Method:

Production method is also named as Value added method. In this method, national income is measured as a flow of goods and services. We calculate money value of all final goods and services produced in an economy during a year. Final goods here refer to those goods which are directly consumed and not used in further production process.

Goods which are further used in production process are called intermediate goods. In the value of final goods, value of intermediate goods is already included therefore we do not count value of intermediate goods in national income otherwise there will be double counting of value of goods.

To avoid the problem of double counting we can use the value-addition method in which not the whole value of a commodity but value-addition (i.e. value of final good value of intermediate good) at each stage of production is calculated and these are summed up to arrive at GDP.

The equation can be written as:

NATIONAL INCOME = G.N.P – COST OF CAPITAL – DEPRECIATION – INDIRECT TAXES

2. Income Method

Under this method the national income is estimated by summing up the income that arrives to the factors of production provided by the national residents. Thus the rate at which the national income is distributed among the various factors of production is estimated. Equation wise the method can represent national income as:

NATIONAL INCOMER = RENTAL INCOME + WAGES + INTEREST + PROFIT

3. Expenditure Method

This method gives national income by adding up all public and private expenditures made on final goods and services during a year. It is obtained by:

- Personal consumption expenditure of goods and services.
- Gross domestic private investment.
- Government purchase of goods and services.
- Net Foreign investment.

So we can measure national income using the following equation:

GDP = C + I + G + NE

It must however be recognized that it is the final expenditure only which must be counted and not the immediate expenditure.