NATIONAL INCOME

National income is the ***total income of a country***.[2] It is the aggregate of all individual incomes plus the income of the government. In order to understand the full meaning of national income, we should first know the meaning of 'income' and sources of income. When a person takes part in the production of goods and services by providing his personal services or the services of his property, he gets some amount of money or some other benefits in return. This is called his income. In this sense there are **four main sources of income**. People may get **rent** of their land and property. They may receive **interest** on money lent or capital invested. They may earn **wages** by working themselves and they may get **profit** by organising some business. If we take the total of all such incomes of all residents of a country during one year, it is called national income of the country.

Since income is generated only when production of goods and services takes place, the **total money value** of the goods and services produced in a country will always be equal to the aggregate of incomes of the persons helping in that production. When a country produces more goods and services, people earn more income. In fact **national income, national production and national output are alternative terms. Therefore, we can define national income in two ways:**

> **"Total market value of all final goods and services produced in a country during one year."** OR

> **"Sum of all incomes received by households, including wages, rents, interest payments and profits during one year."**

Simon **Kuznet**[3] defines national income as, **"The net output of commodities and services flowing during the year from the country's production system in the hands of ultimate consumers."**[4]

Since it is not practical to measure the national production as so many houses, so many cars, so many shirts and so on, produced annually

The following **points** need to be remembered.

(a) National income is the value of total **output of current year** whether it is sold and consumed in the same year or not.

(b) It is a **flow concept** or **flow variable**).[5] i.e. goods and services are being produced and consumed continuously. (Some goods may not be present at the end of the year, but their value must be added because those have been produced in that year).

(c) National income is measured **for one year**.

(d) **National income is a money measure of total production of a country.** We cannot add tons of wheat and metres of cloth etc. However, by using market prices for goods we can add money values of wheat and cloth.

(e) National income includes the net value of **only final goods** which are not to be resold (e.g. the value of shirt is taken and not of cotton, because the value of cotton is already included in the value of the shirt). It also includes the addition to the value of goods, which are still not final and are under process[6].

(f) Incomes from **illegal sources** are not included.

(g) National income does not mean income of the government alone. It is the aggregate of incomes of all nationals of a country.

(h) Gross national product and gross national income are identical terms[7].

CONCEPTS OF NATIONAL INCOME

It is not enough to know the total income of a country for a particular year. We want to make this study more meaningful and a useful guide for economic policies. So we look at national income from different angles. Different concepts of national income have been developed to describe how and where national income is produced; what part of it is taken by the government through taxes; what part is distributed and, after deducting all taxes, how much is left with the people to spend (dispose of). The important concepts used about national income are:[8]

1. GDP (Gross Domestic Product)
2. GNP (Gross National Product)
3. NNP (Net National Product)
4. NI (National Income)
5. PI (Personal Income)
6. DI (Disposable Income)

Gross Domestic Product (GDP)

It is the first measure for national income. Domestic product means total value of production done **within a country**. The concept of GDP ignores the incomes received by its nationals from their property in other countries or the amounts received for services rendered abroad. It only shows what is the sum total of incomes when goods and services are produced with resources located inside a country. Usually two kinds of firms work in a country. The local firms have their origin (or head office) in the same country. Foreign firms, which belong to other countries, have their origin and head office somewhere abroad. For example SERVIS (shoes) is a Pakistani firm while BATA is a foreign firm working in Pakistan. Similarly the individuals working in a country will be either locals or foreigners. Total value of output by all kinds of firms, which they produce inside Pakistan, is included in GDP of Pakistan.

GDP of a country for some year is the total value of goods and services, which have been produced within its geographical boundaries. Thus production of both SERVIS and BATA is included in GDP of Pakistan. The salary of a Japanese engineer working in HONDA factory in Lahore is also included in our GDP, since he performs his services in Pakistan. On the other hand. income of a Pakistani working *in other countries*, say DUBAI is not counted in our GDP since the services have been rendered outside Pakistan.

The following points about GDP should be remembered.

(i) GDP is a **money measure** of total domestic production.

(ii) Only the value of goods produced in **current year** is included.

(iii) Growth rate of GDP is used to judge the success of government economic policies.

(iv) The **relative importance of various sectors** of the economy is determined on the basis of each sector's share in GDP.

(v) Increase in GDP is an indicator that economy is growing and expanding.[9]

Gross National Product (GNP)

GNP is the most important and commonly used concept in national accounting. It is a basic but rough estimate of economic performance of a nation[10]. It measures the total value of output of goods and services produced by the people in or outside their country.[11] GNP is a wider and more comprehensive term than GDP. In addition to domestic production it considers net income received from abroad. It is the yardstick used to estimate and compare the economic position of various countries.[12]

It may be defined[13] as:

> **"GNP of a country for a particular year is the sum of market values of all final goods and services produced for consumption and investment purposes."**

Every country produces various kinds of goods — consumer goods, such as grains, milk, sugar, textiles, shoes and capital goods such as machinery, equipment, buildings etc. At the same time a large number of persons perform different services as engineers, doctors, teachers, artists, clerks and labourers. If the money values of all these goods and services are calculated at market prices and added, we arrive at a figure called gross national product.

Rs. 4018 billion (Provisional)

The meaning of GNP[14] is broader than GDP, which refers to only total domestic production inside a country. GNP includes all production by the residents of a country whether it is done in the country or somewhere abroad. The GNP of a country, say Pakistan, includes the profits of all Pakistani firms and incomes of individuals even if they are working outside Pakistan. Similarly the profits of foreign firms and incomes of foreign individuals working here are excluded.

GNP = GDP *plus* income received by Pakistanis from abroad *minus* income of foreigners taken away from Pakistan.

Or

GNP = GDP *plus* Net Factor Income from abroad

Suppose

GDP			= Rs.140 billion
Plus	Income of Pakistanis from abroad	(+)	= Rs. 30 billion
Minus	Income of foreigners taken away	(–)	= Rs. 20 billion
GNP			= Rs 150 billion

The following points should be remembered about GNP.

(i) It is a **money measure.** Because different units of measurement are employed for different goods, it is not possible to add unlike items such as apples and shoes directly. So their money value is taken and added.

(ii) In order to **avoid double counting,** the values of only final goods are included in the estimate.

(iii) Only the value of goods **produced in current year** is included.

(iv) GNP is **calculated** either by summing total expenditure on all final output or by summing the incomes derived from production of that output.

If expenditure method is used, then[15]   GNP = consumption expenditure + investment expenditure + government spending

(v) GNP is used as a measure of a nation's **welfare**[16].

(vi) It provides basis for economic **comparison** of countries.

(vii) Increase in GNP is an indicator that the **economic performance** of the country has improved.[17]

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[14] **Difference** In national income accounting two kinds of GDP and GNP concepts are used i.e. GNP at market prices (MP) and GNP at factor cost (FC). The difference lies in indirect taxes **GNP at MP – indirect taxes + subsidies = GNP at FC**

GNP at FC is also called National Income

[15] Another point to remember is that GDP and GNP exclude **Non-production transactions (i.e. transfer payments).** These non-production transactions are of two types; (a) purely financial transactions e.g. receiving of money by a student from his parents, pension Zakat etc. These receipts do not entail production but only transfer of funds from one individual to another or from government to private individuals. Similarly buying and selling of old securities, old (share) stocks or bonds are not included. Such buying and selling is only transfer of paper assets. (b) Second hand sales of goods is excluded because either they do not represent current production or involve double counting.

[16] In this regard we must be careful. A measure of total production in a country cannot give a complete picture of the **welfare** of a nation. When we acquire more goods we do not necessarily become happier. Other things such as the quality of environment or sense of accomplishment in work also matter. However total production is one important measure of a country's success or failure in economic field.

[17] Although technically national income has a particular definition, **generally both measures (GDP and GNP) are loosely referred to as 'national income'**

Net National Product (NNP) (or National Income at market prices).

Closely related to the concept of GNP is another concept called NNP of a country. Net national product is a more accurate measure of total value of goods and services produced by a country. It is derived from GNP figures. As a rough estimate, GNP is very useful indicator of total production of a country. But if we are interested to have an accurate and true measure of what a country is producing and what is available for use[18], then GNP has a serious defect. It ignores the fact that some capital is used up during the process of production in the form of decrease in the value of machinery, buildings, etc. For example if a new bus runs for a year, its value will definitely decrease and at the end of the year the value will be less than that of a new bus.

In order to know the total production of an economy, which can be available for use without decreasing its capital stock, NNP is calculated. This is done by deducting some amount for depreciation of capital goods from GNP of that year. Depreciation[19] means the reduction in the value of capital goods due to wear and tear during production process.

NNP = GNP – Depreciation

Suppose the GNP of a country in a particular year is Rs.150 billion. While producing the goods and services included in GNP, machinery has worn out. Similarly the value of the buildings has decreased and a part of equipment and tools have been replaced. Suppose the cost of all this wear and tear is Rs.20 billion. Then,

> **Better measure of national income – GNP or NNP**
>
> NNP is conceptually a better measure of national income. However, GNP is used as main official measure of national income. This is because in practice it is impossible to estimate the exact value of depreciation. Mostly it is an arbitrary percentage. To save income tax the firms give inaccurate value of depreciation. Therefore to compare national income over time GNP is considered a better measure.

GNP	=	Rs. 150 billion
Depreciation allowance (–)	=	Rs. 20 billion
NNP (Net National Product)	=	Rs. 130 billion

NNP is the true measure of national income of a country

National Income (at Factor Cost)

NNP gives us a measure of national income by adding the money values of all goods and services produced by a country in a given period at market prices. But sometimes we are interested to know how much of the total product is going to the people as factor incomes (wages, rent interest and profit). Thus we find national income at factor cost. The total value of NNP is not distributed among the factors of production in the form of wages, rent, interest and profit. There are two causes of difference between NNP and income received by the people. Firstly, a part of NNP is taken away by the government as indirect taxes on commodities such as sales tax and

[18] Without decreasing our stock of capital.
[19] Depreciation is also called capital consumption or Replacement Investment

Disposable income (DI) = Rs. (155 − 10)

PER CAPITA INCOME (Average income)

In order to know the average income of people in a country, per capita[22] income is calculated i.e. income per head of population. It is obtained when national income is divided by population of the country.

Per Capita Income = National Income/Population

Let the national income of a country be Rs.600,000 millions and the population (estimate) as 120 millions. Then per capita income = 600,000/120 = 5000 rupees. Per capita income is annual income per person.

The concept of per capita income is helpful to have an idea of the *average standard of living of the people* of a country[23]. A higher per capita income shows that people have more to consume in terms of goods and services. Lower per capita income implies widespread poverty. If per capita income of a country is compared over some years, we can know whether the country is making any economic progress and whether people's living standard is rising or not.

If we consider the case of Pakistan we are worried to note that our per capita income is one of the lowest in the world. In dollars it is only 450 while for USA or Japan it is more than thirty five thousand. There are many economic, social and political causes for so low income level[24]. An important factor, which keeps our per capita income low, is the fast rising population.

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22 Per Capita means per head.

23 However an increase of, say, 10% in real GNP does not mean that the average person has 10% more goods and services. The reason is that population is growing at the same time.

24 These causes have been discussed in the next chapter.