

Vivekanand College, Kolhapur (Autonomous)

Department of Economics

Subject- Business Economics (Macro)

Topic- Methods of Measurement of National Income

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Methods of Measurement of National Income

1. Production Method
2. Income Method
3. Expenditure Method

1. Production Method-

- This is the most direct method of measuring the economy's production.
- It is also called *output method* or *value added method*.
- This method measures the national income by adding up the market value of all final goods and services produced by all the firms in a country during an accounting year.
- The economy is classified into the different sectors where the income originate.
- There are three major sectors
- Primary sector- agriculture, mining, forestry, fishing and animal husbandry.
- Secondary sector- manufacturing enterprises, gas and electricity supply.
- Tertiary sector- services like transport, communication and banking etc.


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- National income is measured by adding up the net market value of all final goods and services produced by all these producing sectors in a year's time.
 - The one great advantage of this method is that it reveals the relative importance of the different sectors of the economy.

Precautions-

- Imputed rent values of self occupied house should be included in the value of output.
- Only the final goods and services should be included.
- Goods and services produced by the govt for departmental use should be included.
- Value of housewives services should be excluded.
- **Income form foreign sector must be carefully considered.**

2. Expenditure Method

- Expenditure method arrives at national income by adding up all expenditures made on goods and services during a year.
- It is also called consumption – investment method.
- In order to use this method, we should collect data relating to the consumption and investment or expenditure on final consumption by the community.
- We can divide expenditure into four groups
 1. Personal consumption expenditure
 2. Gross private domestic investment expenditure
 3. Government's final consumption expenditure
 4. Net export (X-M)



$GDP_{MP} = \text{Personal consumption expenditure} + \text{Gross private domestic investment expenditure} + \text{Government's final consumption expenditure} + \text{Export} - \text{Import}.$

$$GDP_{MP} = C + I + G + (X - M)$$

Precautions-

1. The expenditure made on second hand goods should be excluded.
2. Expenditure on purchases of shares, bonds etc. should be excluded.
3. Expenditure on transfer payments by govt should be excluded.
4. Expenditure on intermediate goods should not be include.

3. Income Method

- This method approaches national income from distribution side.
- It is also known as factor income method or factor share method.
- In the process of production, goods and services are produced with the help various factors of production. So factor cost is factors' income.
- Under this method the national income is calculated by adding up all the incomes accruing to the all these factors of production.
- Here national income can be measured by two methods, one is Income Received Method and Income Paid Method.



Precautions-

1. Transfer payments should be included.
2. Illegal incomes e.g. the income of smugglers, black marketers etc. should be excluded.
3. Windfall gains such as prizes won, lotteries should not be included.
4. Value of production for self consumption should be included.
5. All indirect taxes are to be excluded.
6. Income of the government and semi-government undertakings should be included.



- **GNP = GNI = GNE**

- All the three methods would give the same measure of national income. However, reliable data of savings and consumption are not easily available.
- It should be noted that no single method can give an accurate measure of national income because country's statistical system does not provide the total requirements for a particular method.
- In India a combination of production method and income method is used for estimating national income.