

CA Foundation Business Economics – Chapter 5: Determination of National Income

1. Meaning of National Income

National Income refers to the total monetary value of all final goods and services produced in an economy during a given period.

Key Definitions:

- GDP: Market value of all final goods & services produced within a country in a year.
- GNP: GDP + Net Factor Income from Abroad (NFIA)
- NNP: GNP – Depreciation
- National Income (at Factor Cost): NNP at market price – Net indirect taxes (NIT)
- Personal Income: Income received by individuals, including transfer payments
- Disposable Income: Personal Income – Personal Taxes

2. Methods of Measuring National Income

Three Methods:

- A. Production Method: GDP = Gross Value of Output – Intermediate Consumption
- B. Income Method: National Income = Rent + Wages + Interest + Profit + Mixed Income
- C. Expenditure Method: GDP = C + I + G + (X – M)

3. Aggregate Demand (AD) and Aggregate Supply (AS)

- $AD = C + I$
- $AS = Y$ (National Income)

4. Determination of Equilibrium Level of National Income

Equilibrium when $AD = AS$ or $S = I$.

Equilibrium Condition: $Y = C + I$, so $S = I$

5. Saving and Investment Approach

$$S = Y - C$$

I = Investment in capital goods

Equilibrium: $S = I$

6. Multiplier Effect

Measures effect of investment on income.

Formula: $K = 1 / (1 - MPC)$

Example: If $MPC = 0.8$, $K = 5$

7. Marginal and Average Propensities

- $MPC = \Delta C / \Delta Y$
- $MPS = \Delta S / \Delta Y$
- $APC = C / Y$
- $APS = S / Y$

$MPC + MPS = 1$, $APC + APS = 1$

8. Underemployment Equilibrium

Equilibrium below full employment level.

Caused by low investment or low aggregate demand.

9. Government Role in Income Determination

Government uses spending and taxes to affect national income.

May use deficit financing to increase income.

10. Limitations of National Income Estimation

- Non-monetised sector excluded
- Informal sector unreported
- Lack of reliable data in developing countries

Important Formulas Recap:

- $GDP = C + I + G + (X - M)$
- $NI = NNP \text{ at FC} = NNP \text{ at MP} - NIT$
- Multiplier $K = 1 / (1 - MPC)$
- $S = Y - C$
- $MPC + MPS = 1$