

# National Income

① What are the names of the famous books written by Prof. Keynes and Prof. Adam Smith?

→ The British economist, Prof. J.M. Keynes published his celebrated book 'The General Theory of Employment, Interest and Money' in 1936. The famous book written by Prof. Smith was 'An Enquiry into the Nature and Causes of Wealth of Nations'.

② Why after having huge natural resources a country may be poor?

→ Resource endowment is not the ~~sole~~<sup>sole</sup> indicator of economic prosperity of a region. In fact, the resource <sup>rich</sup> ~~rich~~ Africa and Latin America have some of the poorest countries of the world. Whereas many prosperous countries have scarcity of natural resources. There was a time when possession of natural resources was the most important consideration but even then the resources had to be transformed through a production process.

The economic wealth of a country thus doesn't necessarily depend on mere possession of resources, the point is how these resources are used in generating income and

employment.

Distinguish between final goods and intermediate goods with examples.

→ A good which will not pass through anymore stages of production or transformation and is ready for use by the final user is called a final good. Final goods are of two kinds —

(a) Final consumer goods / consumption goods like ~~bis~~ biscuit, bread, butter etc.

(b) Final producer goods / capital goods like big machines, tractors, harvestors etc.

On the other hand, intermediate goods are those goods which are purchased by one from the other either for resale or for use as a raw material. Eg: <sup>Balls</sup> ~~Balls~~ of Jute used for making jute-made bags, Copper used for making utensils etc. In fact the following distinctions are observed between final goods and intermediate goods —

(i) Final goods will not pass through anymore stages of transformation but intermediate goods will pass through.

(ii) Value is not to be added to final goods but value is yet to be added to intermediate goods.

(iii) Final goods are included in the estimation of national income but intermediate goods are not included.

4. Why is cooking at home not an economic activity?

→ Cooking at home is not an economic activity even though the product involved undergoes transformation. The reason is, home cooked food is not sold to the market for earning an income. But if the same cooking is done in a hotel, it becomes an economic activity because there is value addition.

5. Whether the same good may be final or intermediate?

→ Yes, A bread, which has moved out of the line of production and is available for final consumption is known as can be termed as a final good. However, if the same bread is used in a restaurant to make a sandwich then it can be termed as an intermediate good.

6. Distinguish between consumption goods and capital goods.

→ Consumption goods and capital goods are two important categories of final goods. Consumption goods are those goods which are directly used for the satisfaction of human wants and are not used in the production of other goods. Eg: Ice-cream, biscuits, etc.

On the other hand, capital goods are those goods which are used in the process of production for several years and which are of high value. Eg:- Plant, machinery etc.

7. Write a note on different types of consumption goods.

→ Consumption goods / consumer goods are broadly classified into four categories as follows:-

(i) Durable consumer goods : These are those goods which can be used repeatedly for several years before they are finished. Eg:- A T.V. set, a washing machine, etc.

(ii) Semi-durable consumer goods : These are those consumer goods which can be used for a period of one year or slightly more. Eg:- Clothes, electric goods etc.

(iii) Non-durable / single use consumer goods : Non-durable goods are those goods which are exhausted in a single use. Eg:- Bread, ink, milk etc.

(iv) Services : services are those non-material goods which directly satisfy human wants. Few examples of services are the services of a doctor, lawyer, domestic servant etc.

$$\begin{array}{r} 1500 \\ 3000 + 1500 = \\ \hline 4500 \end{array}$$

8. Whether all machines are ~~it~~ capital goods.

→ It must be borne in mind that all machines are not capital goods. Eg: A sewing machine in a tailoring shop is a fixed ~~asset~~ asset of the tailor and hence a capital good. But the same machine with a consumer household is not a capital good. It is simply a durable consumer good.

9. 'All capital goods are producer goods but all producer goods are not capital goods' — Explain.

→ Producer goods are those goods which are used in the process of production. These goods include —

- (i) Raw materials, like wood used to make furniture.
- (ii) Fixed assets, like plants and machineries.

Unlike fixed assets of the producer, raw materials are not durable use goods. These are single use producer goods and cannot be ~~repeatedly~~ repeatedly used in the process of production. Fixed assets / capital goods, on the other hand are repeatedly used in the process of production. These are durable use producer goods. Hence, it is clear that while all capital

are producer goods, all producer goods are not capital goods.

10. 'A machine is not always a final good' —  
Do you agree. Give reasons.

→ Machines (like a washing machine) purchased by a household is a ~~firm~~ final good. It is like a consumer durable. Similarly a machine (like a producing unit) purchased by a firm is also a final good; as it is to be finally used by the producer in the process of production. However, a machine purchased by one firm from the other for purpose of resale is an intermediate good.

11. Define Intermediate consumption.

→ Expenditure on inter-mediate goods by the producers during an accounting year is called intermediate consumption.

Value of output (say of chairs) — Intermediate consumption (wood and other materials used in chairs) =  
value of output (say of chairs) — intermediate consumption (wood and other materials used in chairs) = Gross value addition by the producers.

12. Why should we consider only final goods in the estimation of national income?

OR.

Explain the significance of the distinction between final goods and intermediate goods.

→ We know that, intermediate goods are those goods which are purchased by one firm from the other, either for resale or for use as raw material in the production of other goods and services. When these goods are used as ~~in~~ raw material, in the ~~process~~ production of final goods, the value of intermediate goods gets automatically included in the value of final good.

To illustrate let firm A bought cloth for ₹ 1000 to be used as raw material in the production of shirts. The shirts were sold for ₹ 3000. This value of ₹ 3000 includes the value of cloth viz. ₹ 1000. Therefore, in the calculation of national income, the value of only final goods, i.e. shirts of ₹ 3000 would be included. If we include the value of intermediate goods also ( $₹ 3000 + ₹ 1000 = ₹ 4000$ ), it would cause double counting. Thus in the calculation of national income, the value of only final goods is taken into account.

3. Define Investment. Mention its types.

→ Addition to the stock of capital of a firm is known as Investment. In other words,  ~~$I = \Delta K$~~

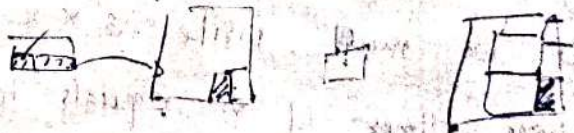
$I = \Delta K$ , where  $I$  = Investment,  $K$  = Capital stock and  $\Delta K$  = change in the capital stock during a year.

Investment is <sup>mainly</sup> ~~is~~ ~~namely~~ of two types.

(i) Fixed Investment: It refers to the increase in the stock of fixed assets of the producer during 1 year. Expenditure of the producer on the purchase of fixed assets like machinery, factory building etc. causes fixed investment.

(ii) Inventory Investment: Change in the inventory stock (unsold finished or semi finished goods) of the producer during a year is called inventory investment.

Apart from the above two types of investment, a third category of investment is also made i.e. known as residential investment — an ~~invest~~ investment which refers to the addition of housing facilities.



14. Define Inventory. What is called accumulation and decumulation of inventories?

→ In economics, the stock of unsold finished goods or semi finished goods or raw materials which

a firm carries from 1 year to the next is called <sup>inventory</sup> <sup>and</sup> inventory. It is a stock variable.

If the value of inventories is more at the end of the year compared to the beginning of the year, inventories have increased or accumulated.

On the other hand, if the value of inventories at the end of the year is less at the end of the year compared to the beginning of the year, inventories have decreased or decumulated. Thus, we can say that change of inventories of a firm during a year  $\equiv$  production of the firm during the year - sale of the firm during the year.

15. What is the difference between identity and equality?

→ The sign ' $\equiv$ ' stands for identity. Unlike equality (' $=$ '), an identity always holds irrespective of what variables we have on the left hand and right hand sides of it. Eg: we can write

$3 + 3 \equiv 6$  because this is always true but we must write  $3 \times x = 6$ . This is because three times of 'x' equals to six, for a particular value of x (viz, when  $x = 2$ ) and not always.

16. Explain the concept of planned and unplanned change in inventories.

OR

Write a note on planned or unplanned accumulation and decumulation of inventories.

→ Change in Inventories may be planned or unplanned.

In case of an unexpected fall in sales, the firm will have unsold stock of goods which it had not anticipated.

Hence, there will be unplanned accumulation of inventories. In the opposite case, when there is unexpected rise in the sales there will be unplanned decumulation of inventories.

Let us suppose a firm produces shirts and it starts the year with an inventory of 100 shirts. During the coming year, it expects to sell 1000 shirts. Hence, it produces 1000 shirts expecting to keep an inventory of 100 at the end of

the year. However, during the year the sales of shirts turn out to be unexpectedly low. The firm is able to sell only 600 shirts. This means that the firm is left with 400 unsold shirts.

The firm ends the year with an inventory of ~~400~~  $400 + 100 = 500$  shirts. This unexpected rise of inventories by 400 will be an example of unplanned accumulation of inventories. If, on the

other hand, the sales had been more than 1000, we would have unplanned decumulation of

inventories. Eg: If the sales had been 1050, then not only the production of 1000 shirts will be sold,

the firm will have to sell 50 shirts out of inventory. This 50 unexpected reduction in inventories is an example of unplanned decumulation of inventories.

To illustrate planned accumulation and decumulation of inventories let us suppose the firm wants to raise the inventories from 100 shirts to 200 ~~st~~ shirts during the year expecting st. sales of 1000 shirts. During the year, the firm produces  $1000 + 100 = 1100$  shirts. If the sales are actually 1000 shirts, then the firm ~~indeed~~ ends up with a rise of inventories. The new stock of inventories is 200 shirts which was ~~indeed~~ indeed planned by the firm. This rise is an example of planned accumulation of inventories. On the other hand if the firm had wanted to reduce the inventories from 100 to 25, then it will produce  $1000 - 75 = 925$  shirts. This is because it plans to ~~e~~ sell 75 shirts out of the inventory of 100 shirts. It started with 100 shirts. If the sales ~~indeed~~ indeed turn out to be 1000 as expected by the firm, the firm will be left with the planned reduced inventory of 25 shirts.

Write a note on gross investment and net investment.  
→ The part of our final output that comprises of capital goods (machines, buildings or infrastructure) constitutes gross investment of an economy.

When depreciation charges are deducted from gross investment, we get net investment for an economy.

That is  $\text{net investment} = \text{Gross investment} - \text{Depreciation}$ .

#18. Define depreciation and depreciation reserve fund.

→ Depreciation is the loss of fixed assets in use on account of normal wear and tear and normal rate of accidental damages.

On the other hand depreciation reserve fund is an annual provision of funds for the replacement of fixed assets when these are worn out or when these become outdated. Eg: If a machine is purchased for ₹ 10 lac and its expected lifetime of use is 10 years, then the annual provision for funds (to replace the machine after 10 years) =  $\frac{₹ 10 \text{ lac}}{10} = ₹ 1 \text{ lac}$ . This is called depreciation reserve fund.

19. Distinguish between consumption of fixed capital and capital loss.

→ Consumption of fixed capital refers to loss of the value of fixed assets while these are

being used in the process of production. On the other hand capital loss is the loss of value of fixed assets while these are not in use. It occurs on account of (a) Natural calamities and (b) Fall in the market value of assets.

20. What is current replacement cost?

→ It refers to the ~~estimated~~ estimated value of depreciation for all the producing units in the economy during the period of one year.

21. Distinguish between stock and flow with the help of examples.

→ A stock is a quantity measured at a particular point of time. On the other hand, a flow is a quantity measured over a specified period of time.

Some examples of stocks and flows are given below:—

| <u>Stock</u>                          | <u>Flow</u>                                         |
|---------------------------------------|-----------------------------------------------------|
| (i) Wealth                            | (i) Income                                          |
| (ii) Capital                          | (ii) Capital formation                              |
| (iii) Quantity of Money in a country. | (iii) Change in the quantity of money in a country. |
| (iv) Bank deposits.                   | (iv) Interest on capital.                           |
| (v) Water in the overhead tank.       | (v) Leakage of water from the overhead tank.        |

In fact, the following relations / differences are observed between stock and flow :

### Stock

- (i) It relates to a point of time.
- (ii) Stock is not time dimensional.
- (iii) Stock influences the flow. Greater the stock of capital, greater is the flow of goods and services.

### Flow

- (i) It relates to a period of time.
- (ii) Flow is time dimensional as, per hour, per month etc.
- (iii) Flow influences the stock. Eg: Monthly increase in the supply of money leads to an increase in the quantity of money.

22. Are the following stocks or flows ?

- (i) Investment (ii) Monetary Expenditure (iii) A 200 rupee note (iv) Services of a teacher (v) Production of cement (vi) Machinery of a jute mill.

→ (i) Investment — Flow

(ii) Monetary Expenditure — Flow

(iii) A 200 rupee note — Stock

(iv) Service of a teacher — Flow

(v) Production of cement — Flow

(vi) Machinery of a jute mill — Stock