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Topic- National Income Accounting

National Income Accounting Equation

The national income equation represents the relationship between national income and the economy's expense, along with other attributes, as shown in the following equation:

$$Y = C + I + G + (X - M)$$

Where:

- Y – National income
- C – Personal consumption expenditure
- I – Private investment
- G – Government spending
- X – Exports
- M – Imports

National Income Accounting Methods

The following methods are used to measure national income:

1. Product method

Also known as the value-added method, the product method is based on the net value added to the product at every stage of production. In the product method, the economy is usually divided into different industry sectors, such as fishing, agriculture, and transport.

The national income is calculated by adding the total output of the companies in the economy. The method shows the contribution of each sector to the national income, hence demonstrating the importance of different sectors relative to each other.

2. Income method

In the income method, the national income is measured by adding up the pretax income generated by the individuals and companies in the economy. It consists of income from wages, rent of buildings and land, interest on capital, profits, etc. in an accounting year. The income method shows the national income distribution among different earning groups in the economy.

3. Expenditure method

In the expenditure method, the national income is measured by adding up the expenditures made by individuals, companies, and the government. Thus, it combines consumer spending, investments made by companies, net exports, and government spending to calculate the national income.

Importance of National Income Accounting

- The statistics provided by national income accounting can be used to simplify the procedures and techniques used to measure the aggregate input and output of an economy.
- The data provided is used to frame government economic policies, and it also helps in recognizing the systemic changes happening in the economy.
- National income accounting provides information on the trend of economic activity level. Various social and economic phenomena can be explained through the data, which helps the policymakers in framing better economic policies.
- Central banks can use the national income accounting statistics to vary the rate of interest and set or revise the monetary policy.

- The data on GDP, investments, and expenditures also helps the government to frame or modify policies regarding infrastructure spending and tax rates.
- The national income accounting data also shows the contribution of different sectors, relative to each other, towards economic growth

Criticisms of National Income Accounting:

The accuracy of analysis relating to national income accounting is only as accurate as the data collected. Failure to provide the data in a timely fashion can render it useless in regard to policy analysis and creation.

Additionally, certain data points are not examined, such as the impact of the underground economy and illegal production. This means the activities are not reflected in the analysis even if their effect on the economy is strong. As a result, certain national accounts such as GDP or the consumer price index (CPI) of inflation have been criticised on the grounds that they do not accurately capture the real economic condition of the economy.