What is national income accounting economics essay

\n[toc title="Table of Contents"]\n

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1. Explain different price indices and their differences. \n \t
2. What does IS-LM curve describe? \n \t
3. Why should fiscal and monetary policies go hand in hand? \n

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Ans: National income refers to the total value of goods and services produced in the country in a given year. National income is also known as net national product at factor cost.

The need for national income accounting to throw light on distribution of income in society

Various methods of estimating national income

Product method

The product or output method focuses on finding the total output of a nation by directly finding the total value of all goods and services produced in a nation. The total value refers to the final value of goods and services in order to avoid the problem of double-counting.

FORMULA:

NNP at the factor cost = GDP at the MP – Depreciation + NFIA (Net Factor Income) – net indirect taxes

GDP (gross domestic product) at MP = value of output in an economy in a particular year – intermediate consumption

Income method

According to this method, national income is the summation of the rewards given to different factors of production.

FACTORS OF PRODUCTION

REWARD

Land

Rent

Labor

Wages

Capital

Interest

Enterprise

Profit

FORMULA:

National income = Compensation of employees + Net interest + Rental & royalty income + Profit of incorporated and unincorporated firms + Income from self-employment+ NFIA (net factor

Income from abroad) – Depreciation

Expenditure method :

This method finds the total amount of money spent in order to find the total output of a nation. The expenditure method does so because, the amount of money spent on the goods are taken as the total value of goods.

GDP = C + I + G + (X-M)

WHERE,

C = consumption of household expenditure

I = investment

G = government consumption and gross expenditures

X = exports

M = imports

(All the national income formula referred from: http://en. wikipedia. org/wiki/Measures_of_national_income_and_output)

Explain different price indices and their differences.

Ans: The different price indices are:

The GDP Deflator

Nominal GDP

GDP Deflator = Real GDP

It is a widely based price index that is frequently used to measure inflation since it is based on a calculation involving all the goods produced in the economy. It compares and measures the change in the prices that has occurred between the base and the current year.

The consumer price index

The CPI measures the cost of buying a fixed basket of goods and services representative of the purchases of urban consumers.

Differences in GDP Deflator and CPI

The CPI covers a narrower group of goods as compared to the GDP Deflator.

The cost of basket of goods included in the GDP Deflator differs from year to year whereas that of the CPI remains the same.

The CPI directly includes prices of imports, whereas the deflator includes only prices of goods produced in the given country.

The producer price index

The PPI is the measure of the cost of a given basket of goods.

Differences in CPI and PPI

PPI differs from CPI in its coverage.

PPI is designed to measure prices at an early stage of the distribution system unlike CPI

This makes the PPI a relatively flexible price index.

What does IS-LM curve describe?

(Figure Referred from www. google. com)

The IS curve shows the combinations of interest levels and levels of output such that planned spending equals income. It is negatively sloped because an increase in the interest rates reduces planned investment spending equals income. The IS curve is negatively sloped because an increase in the interest rate reduces planned investment spending and therefore reduces aggregate demand, thus reducing the equilibrium level of income. The IS curve is steeper when the multiplier is smaller and investment spending is less sensitive to changes in the interest rate. The IS curve shifts because of changes in autonomous spending. An increase in autonomous spending shifts the IS curve to the right.

The LM curve shows combinations of interest rates and levels of output such that money demand equals money supply. The LM curve is positively sloped. The LM curve is steeper when the demand for money responds strongly to income and weakly to interest rates. A change in money supply causes shifts in the LM curve. An increase in the money supply shifts the LM curve to the right.

The aggregate demand schedule maps out the IS-LM equilibrium holding autonomous spending and the nominal money supply constant and allowing prices to vary.

Why should fiscal and monetary policies go hand in hand?

Monetary policy – the goals of monetary policy are:

To Achieve or maintain full employment

To maintain high economy growth rate

Price stabilization

That affects the economy in 2 ways –

It affects the interest rate

It affects the aggregate demand

In money supply interest rate investment spending and aggregate demand

Equilibrium output

Fiscal policy – fiscal policy influences:

The normal pattern of economic activity

The level and growth of aggregate demand, employment and demand.

It does so with the use of taxation, borrowing and government spending,. It affects both aggregate demand and aggregate supply.

So, how can both the policies are used for the balancing or growth of economy?

During high inflation, government can use fiscal policy to increase taxes in order to remove or draw out money from the economy. It can also decrease the government spending, thereby decreasing the money in circulation. The main impact of monetary policy is on inflation and interest rate. Its primary function is to control the inflation. Any business goes through periods of expansions and contractions and monetary policy attempts to minimize the speed and severity of these expansions and contractions. Unemployment is low because economic stability is maintained inflation controlled. By understanding the impact of both the policies it is understood that each is necessary for maintaining the stability of the economy and growth of the economy. Fiscal policy can be used during deflation and Monetary policy during inflation.