UPSC
NCERT Summary
An Introduction- 2

(v) Net National Product

In the production process a country uses machines and equipment. When there is depreciation, we have to repair or replace the machinery. The expenses incurred for this are called the depreciation expenditure. Net National Product is calculated by deducting depreciation expense from gross national product.

(vii) NNP = GNP – Depreciation

National Income is calculated by deducting indirect taxes from Net National Product and adding subsidies. National Income (NI) is the NNP at factor cost.
NI = NNP - Indirect Taxes + Subsidies

(viii) Per Capita Income

- Per Capita Income is per capita GDP: GDP divided by mid year population of the corresponding year.
- The growth of GDP at constant price shows an annual real growth.
- The real GDP per capita of an economy is often used as an indicator of the average standard of living of individuals in that country, and economic growth is therefore often seen as indicating an increase in the average standard of living.

(ix) Aims of Economic Growth

The following aims can be attributed to the study of economic growth:
(1) When growth is quantified , we can understand whether it is adequate or not for the given goals of the economy.
(2) We can understand its potential and accordingly set targets.
(3) We can adjust growth rates for their sustainability.
(4) We can prevent inflation or deflation to some extent if we see the performance of the economy in quantitative terms.
(5) We can balance the contributions of the three sectors of the economy and steer the direction of growth towards national goals- away from agriculture to

manufacturing as in the case of India in recent years.
(6) Target appropriate levels of employment creation and poverty alleviation.
(7) Fore cast tax revenues for governmental objectives.
(8) Corporates can plan their business investments.

(x) Problems for Calculating National Income

The measurement of national income encounters many problems. The problem of double-counting. Though there are some corrective measures, it is difficult to eliminate double-counting altogether. And there are many such problems and the following are some of them.

(1) Black Money

Illegal activities like smuggling and unreported incomes due to tax evasion and corruption are outside the GDP estimates. Thus, parallel economy poses a serious hurdle to accurate GDP estimates. GDP does not take into account the 'parallel economy' as the transactions of black money are not registered.

(2) Non-Monetization

In most of the rural economy, considerable portion of transactions Occurs in formally and they are called as non monetized economy- the barter economy. The presence of such non-monetary economy in developing countries keeps the GDP estimates at lower level than the actual.

(3) Growing Service Sector

In recent years, the service sector is growing faster than that of the agricultural and industrial sectors. Many new services like business process outsourcing (BPO) have come up. However, value addition in legal consultancy, health services, financial and business services and the service sector as a whole is not based on accurate reporting and hence underestimated in national in come measures.

(4) Household Services

The national in come accounts do not include the 'care economy'- domestic work and housekeeping. Most of such valuable work rendered by our women at home does not enter our national accounting.

(5) Social Services
It ignores voluntary and charitable work as it is unpaid.

(6) Environmental Cost

National income estimation does not account for the environmental costs incurred in the production of goods. For example, the land and water degradation accompanying the Green revolution in India. Similarly, the climate change that is caused by the use of fossil fuels. However, in recent years, green GDP is being calculated where the environmental costs are deducted from the GDP value and the Green GDP is arrived at.

GDP deflator

- GDP Deflator is a comprehensive measure of inflation, implicitly derived from national accounts data as a ratio of GDP at current prices to constant prices. While it encompasses the entire spectrum of economic activities including services, it is available on a quarterly basis with a lag of two months since 1996. Therefore, national income aggregates extensively use WPI for deflating nominal price estimates to derive real price estimates.
- The formula used to calculate the deflator is:
  GDP deflator = (Nominal GDP / Real GDP) X 100
- Dividing the nominal GDP by the GDP deflator and multiplying it by 100 would then give the figure for real GDP, hence deflating the nominal GDP into a real measure.
- A price deflator of 200 means that the current-year price of this computing power is twice its base-year price - price inflation. A price deflator of 50 means that the current year price is half the base year price - price deflation.
- Unlike some price indexes, the GDP deflator is not based on a fixed basket of goods and services. It covers the whole economy.
- Specifically, for GDP, the “basket” in each year is the set of all goods that were produced domestically, weighted by the market value of the total consumption of each good. Therefore, new expenditure patterns are allowed to show up in the deflator as people respond to changing prices. The advantage of this approach is that the GDP deflator reflects up to date expenditure patterns.
- The CSO uses the price indices to reach the base year figure from the current year one. In September 2010, for the first quarterly figure, it made a mistake while applying the deflator- for the GDP by output figure, it used one price index and for the GDP by expenditure number, it used another. It led to huge discrepancy.

(xi) Business Cycles

Alternating periods of expansion and decline in economic activity is called business cycle. That is, the ups and downs of the economy. There are four stages in the business cycle: expansion, growth, slowdown and recession. Recession may not follow every time. When recession takes place, it may not be of the same intensity every times. For example, the 2008 global financial meltdown is the deepest since the WW2 and is called the Great Recession. If recession deepens, it is called depression and occurred only once in the last century in I930's . All economies experience economic cycles. Explaining and preventing these fluctuations is one of the main focuses of macroeconomics.

(xii) Benefits and Side Effects of Economic Growth

(1) The first benefit of economic growth is wealth creation. It helps create jobs and increase incomes.
(2) It ensures an increase in the standard of living, even if it is not evenly distributed.
(3) Government has more tax revenues: fiscal dividend. Economic growth boosts tax revenues and provides the government with extra money to finances pending projects. For example, the flagship programmes of the government like the MGNREGA are a direct result of the tax buoyancy of growth It sets up the positive spiral:
(4) rising demand encourages investment in new capital machinery which helps accelerate economic growth and create more employment.

Economic growth can also have a self defeating effect:

(1) violate the principles of fairness and equity thus setting off social conflicts.
(2) Environmental costs are another disadvantage.

(xiii) Measure Of Real Progress FOR GDP

Ans. Economic growth is generally taken as the measure of advancement in the standard of living of the country. Countries with higher GNP often score highly on measures of welfare, such as life expectancy. However, there are limitations to the usefulness of GNP as a measure of welfare:
(1) GDP does not value intangibles like leisure, quality of life etc. Quality of life is determined by many other things than economic goods.
(2) The impact of economic activity on the environment may be harmful pollution, climate change, unsustainable growth, ecological refugees, life style diseases etc.
(3) It only gives average figures that hide stratification. Economic in equality is not

revealed by GDP figures Condition of poor is not indicated For example, Indian economy grew at 8.9% in the first half of 2010-2011 but the food inflation was over 14% and on a high base causing immiserization of the lower classes.
(4) Gender disparities are not indicated.
(5) It does not matter how the increase in wealth takes place- whether by civilian demand or war.
(6) GDP does not measure the sustainability of growth. A country may achieve a temporarily high GDP by over-exploiting natural resources.

Advantages

The major advantages to using GDP per capita as an indicator of standard of living are that it is measured frequently, widely and consistently. Frequently in that most countries provide information on GDP on a quarterly basis, which allows a user to spot trends more quickly. Widely in that some measure of GDP is available for practically every country in the world, which allows crude comparisons between the standard of living in different countries. And consistently in that the technical definitions used within GDP are relatively consistent between countries, and so there can be confidence that the same thing is being measured in each country.

Disadvantages

- The major disadvantage of using GDP as an indicator of standard of living is that it is not, strictly speaking, a measure of standard of living. For instance, in an extreme example, a country which exported 100 per cent of its production would still have a high GDP, but a very poor standard of living.
- The argument in favour of using GDP is not that it is a good indicator of standard of living, but rather that (all other things being equal) standard of living tends to increase when GDP per capita increases. This makes GDP a proxy for standard of living, rather than a direct measure of it.
- Because of the limitations in the GDP concept, other measures of welfare such as the Human Development Index (HDI), Index of Sustainable Economic Welfare (ISEW), Genuine Progress Indicator (GPI) and Sustainable National Income (SN1), Gross National Happiness (GNH), Green GDP, natural resource accounting have been suggested.
- They are proposed in an attempt to give a more complete picture of the level of well being and the position with reference to natural resource depletion, but there is no consensus as to which is a better measure than GDP. Some of the above defy quantification. GDP still remains by far the most often-used measure.

(xiv) Other Measures Used as Alternative to GDP

Some economists have attempted to create a replacements for GDP which attempt to address many of the above criticisms regarding GDP. Other nations such as Bhutan have advocated gross national happiness as a standard of living, claiming itself as the world's happiest nation.

HDI

- The UN Human Development Index (HDI) is a standard means of measuring well being. The index was developed in 1990 by the Pakistani economist Mahbub ul Haq, and has been used since 1993 by the United Nations Development Programme in its annual report.
- The HDI measures the average achievements in a country in three basic dimensions of human development:
  (1) A long and healthy life, as measured by life expectancy at birth.
  (2) Knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary, and tertiary gross enrolment ratio (with one - third weight).
  (3) A decent standard of living, as measured by gross, domestic product (GDP) percapita at purchasing power parity (PPP) in US Dollars.
- Each year, UN member states are listed and ranked according to these measures.
- India is ranked at 134 among 182 countries on the Human Development Index of the United Nations Development Programme (UNDP) that was released in late 2010. The HDI goes beyond a nation's gross domestic product (GDP) to measure the general well-being of people under a host of parameters, such as poverty levels, literacy and gender-related issues.

HPI

An alternative measure, focusing on the amount of poverty in a country, is the Human Poverty Index. The Human Poverty Index is an indication of the standard of living in a country, developed by the United Nations.
Indicators used are:
(1) Lifespan
(2) functional literacy skills
Long-term unemployment
(3) Relative poverty ('poverty with reference to the average per capita income).

GPI

- The Genuine Progress Indicator (GPI) is a concept in green economics and welfare economics that has been suggested as a replacement metric for gross domestic product (GDP) as a metric of economic growth. Unlike GDP it is claimed by its advocates to more reliably distinguish uneconomic growth - almost all advocates of a GDP would accept that some economic growth is very harmful.
- A GPI is an attempt to measure whether or not a country's growth, increased production of goods, and expanding services have actually resulted in the improvement of the welfare (or well-being) of the people in the country.

(i) Green GDP

- Green Gross Domestic Product (Green GDP) is an index of economic growth with the environmental consequences of that growth factored in. From the final value of goods and services produced, the cost of ecological degradation is deducted to arrive at Green GDP.
- In 2004, Wen Jiabao, the Chinese premier, announced that the green GDP index would replace the Chinese GDP index. But the effort was dropped in 2007 as it was seen that the conventional growth rates w ere decelerating.

GNH

- Gross National Happiness (GNH) is an attempt to define quality of life in more holistic and psychological terms than Gross National Product.
- The term was coined by Bhutans former King Jigme Singye Wangchuck in 1972 to indicate his commitment to building an economy that would serve Bhutan's unique culture based on Buddhist spiritual values.While conventional development models stress economic growth as the ultimate objective, the concept of GNH is based on the premise that true development takes place when material and spiritual development occur side by side to complement and reinforce each other. The four dimensions of GNH are the promotion of equitable and sustainable socio- economic development, preservation and promotion of cultural values, conservation of the natural environment, and establishment of good governance.

(i) Natural Resources Accounting

- Natural resources are essential for production and consumption, maintenance of life-support systems, as well as having intrinsic value in existence for inter-generational and other reasons. It can be argued that natural capital should be treated in a similar manner to man made capital in accounting terms, so that the ability to generate income in the future is sustained by using the stock of natural capital judiciously. By failing to account reductions in the stock of natural resources, standard measures of national income do not represent economic growth genuinely. Soil, water and bio diversity are the three basic natural resources.
- National Biodiversity Action Plan published by Government of India, Ministry of Environment and Forests in 2008 highlights as an action point the valuation of goods and services provided by bio diversity. More specifically, the Action Plan states : to assign appropriate market value to the goods and services provided by various ecosystems and strive to incorporate these costs into national accounting.
- In the Nagoya (Japan) meet in 2010 on biodiversity protection, India declared that it will adopt natural resource accounting from 2012.
- In the October 2010 UN biodiversity summit, it was said that the link between economic policy, natural capital and human well being should be under stood. There should be global partnership is to mainstream natural resources accounting into economic planning. India, Colombia and Mexico accepted it. This will plug deficiencies in traditional accounting systems. As mentioned above, India's national biodiversity action plan has already incorporated some of these concepts.
- **(ii) Laissez-faire Doctrine**
  A market economy is an economic system in which goods and services are traded, with the price being determined by demand and supply.
- Laissez-faire is a French phrase meaning "let do, let go, let pass." Its proponents make arguments against government interference with economy and trade. It is synonymous with free market economics. It is generally under stood to be a doctrine opposing economic - interventionism by the state beyond the extent which is perceived to be necessary to maintain peace and property rights.
- A market economy has no central coordinator guiding its operation, yet theoretically self - organization emerges amidst the complex interplay of supply and demand. Supporters of a market economy generally hold that the pursuit of self- interest is actually in the best interest of society. Adam Smith says:
- "By pursuing his own interest (an individual) frequently promotes that of the society more effectually than when he really intends to promote it." (Wealth of Nation).

- Adam Smith calls it the invisible hand-the force that combines the individual self interest into a collective social interest. However, as we have seen in the melt down of the western economies since 2008 and as Nobel laueate Joseph Stiglitz commented, invisible hand may not exist.
- There are a variety of critics of market as an organizing principle of an economy. These critics range from those who reject markets entirely, in favor of a planned economy, such as that advocated by communism to those who wish to see them regulated to various degrees. One prominent practical objection is the environmental pollution generated. Another is the claim that through the creation of monopolies, markets sow the seeds of their own destruction.