

# Measurement of National Income Expenditure Method

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## **ABSTRACT:**

An essential method in economics for determining the general level of economic activity inside a nation is the assessment of national income using the expenditure method. It entails calculating overall spending and its contribution to national revenue by examining the various expenditure components, such as consumption, investment, government expenditures, and net exports. An overview of the significance and uses of the expenditure approach for measuring national income are given in this chapter. The spending method provides a thorough framework for comprehending and assessing the functioning of an economy. It represents household spending patterns and offers insights into consumer behavior and preferences by taking consumption expenditure into account.

## **KEYWORDS:**

Aggregate Demand, Consumption Investment, Expenditure Method, Government Spending, National Income.

## **I. INTRODUCTION**

You must have studied the ideas of income and expense, assets and liabilities, profit and loss, etc. in your fundamental accounting studies. These ideas are crucial because they lay the financial groundwork for a prosperous firm. But it doesn't end there. All of these ideas are critical to the health of an economy. Let's examine the Income method and Expense. The formula for calculating Nat the total money made by all citizens and businesses in a nation during a given time period is known as the national income or gross national income. The total value of all commodities and services generated within a certain time period can also be used to define national income. Currently, there are numerous ways to determine national income. The value-added method, the income method, and the spending method are the three most popular approaches. During each stage of a product's production, value is added, according to the value-added technique. The income technique then concentrates on the income made from sources of production like labor and land. The expenditure method, in addition, concentrates on the various expenditures based on consumption and investment. Let's take a closer look at the income and expense methods [1], [2].

1. View related National Income Accounting topics.
2. Some Fundamental Macroeconomic Concepts.
3. Circular Flow of Income and National Income Calculation Techniques.
4. A few macroeconomic characteristics.
5. GDP, welfare, prices, and goods.

## **Income Approach**

The money earned from the primary elements of production is taken into consideration when computing national income using the income method. These include the capital, organization, labor, and land. Additionally, mixed income is a significant part of income in addition to money derived from these forces of production. Let's now go through each of these elements in more detail. Rent is the fee you pay to use a piece of property. Rent solely refers to the money obtained from using any land when

determining income. It is not considered to be rent when a fee is paid for the use of machinery and other equipment. Royalties are now another source of revenue in addition to rent. The payment you make to a person or business in return for the usage of resources like coal or gas is known as a royalty. Your compensation may include the salaries and payments you receive in return for the expertise and services you contribute to the creation of goods and services. In addition, it covers things like bonuses, lodging expenses, and medical payments. Pay in the form of social security programmers, such as insurance, pensions, and provident funds, is a significant component of compensation in addition to earnings and salaries.

### **Expenses for Capital**

Interest is the cost you incur when using borrowed money. This now covers the interest paid when a business borrows money to make an investment. Similar to this, when a family invests in real estate or a home, they borrow money from a bank and pay interest while paying off the debt over time. However, economists only take into account the interest that production units pay when computing national income.

### **Organizational Gains**

The money that businesses make while creating goods and services is referred to as profits. Today, businesses share their gains with shareholders in the form of dividend payments and income tax payments to the government. Undistributed profit is the sum that is still available after taxes and dividends have been paid. The term mixed income describes the earnings of sole proprietorships, farms, and independent contractors. Now, if you take into account all of these sources of income, national income can be shown as follows: Rent, compensation, interest, profit, and mixed income make up national income. When calculating national income, economists' categories the various production units into distinct sectors. The total national income is then derived after calculating the income for each sector. However, economists do not include transfer payments like gifts and donations or profits from the sale of used items when calculating national income using the income approach. Additionally, they do not include earnings from the selling of shares and bonds [3]–[5].

### **Spending Procedure**

Now that you are familiar with the national income calculation method based on income, let's examine the method based on expenditures. The final spending strategy concentrates on the costs incurred during the creation of goods and services. Spending can now be divided into categories depending on consumption and investment. Household consumption of goods and services is included in consumption expenditures (C). It also includes the money spent by the government on supplies and services to meet social welfare needs (G). Investment expenditure is the term used to describe the costs incurred by businesses and manufacturing units when obtaining capital (I). For instance, investment expenditures cover the cost of purchasing fixed capital items like furniture and machinery.

Additionally, an increase in the stock of raw materials is included in expenditure. Investing money can also be used to buy valuables like jeweler or precious metals. Spending includes both government and corporate imports and exports. Additionally, you must include in net exports (NX) when computing national income. Total imports minus total exports equals that. Now, in order to calculate national income using the expenditure method, you must also subtract indirect taxes and capital asset depreciation. The following is a representation of national revenue using the expenditure approach: Household consumption (C) plus government spending (G), investment costs (I), and net exports (NX) equal the national income. Again, when calculating income using the expenditure method, you must disregard spending on used goods, buying stocks and bonds, paying for transfer payments (pension, unemployment insurance), and buying intermediate goods[6], [7].

## **II. DISCUSSION**

The expenditure approach is a way of figuring out gross domestic product (GDP) that includes net exports, government spending, investment, consumption, and investment. It is the most typical method

of estimating GDP. It states that all the government spends and all private sector spending, including consumer and business spending, must equal the entire worth of all finished goods and services produced over a specific time period. By using this procedure, nominal GDP is generated, which must then be adjusted for inflation to get real GDP. For calculating GDP, the income approach can be contrasted with the expenditure approach. How to Use the Expenditure Method Spending is implied by the word expenditure. Demand is another word for consumer spending in economics. Aggregate demand is the economic term for all consumer expenditure. Because of this, the formula for computing GDP and aggregate demand are identical. A consequence of this is that changes in aggregate demand and GDP must coincide. In the real world, this similarity isn't necessarily there, especially when considering GDP in the long run. Only total output for a single nominal price level, or the average of current prices over the full range of products and services produced in the economy, is measured by short-run aggregate demand. In the long run, aggregate demand only equals GDP after taking price level into account [8], [9].

The most popular technique for calculating GDP, which is a measurement of the output of the economy created inside a nation's boundaries regardless of who owns the means of production, is the expenditure method. According to this approach, the GDP is estimated by adding up all of the payments made for finished goods and services. Consumption by families, corporate investment, government spending on goods and services, and net exports which are equal to exports minus imports of goods and services are the four primary aggregate expenditures that go into calculating GDP. The Expenditure Method's Principal Elements Consumer spending, which makes up the majority of U.S. GDP, is the most important factor when calculating GDP in the country using the expenditure method. Purchases of durable items like vehicles and computers, nondurable products like clothing and food, and services make up the majority of consumer spending. The second factor is government spending, which includes what state, local, and federal governments spend on both defense-related and non-defense-related goods and services including weapons, healthcare, and education.

One of the most unpredictable factors that goes into determining GDP is business investment. It covers the capital outlays made by businesses for assets like real estate, machinery, manufacturing facilities, and plants that have useful lives longer than a year. Net exports, which depicts the impact of international commerce on the economy, is the final element in the expenditure method. Based on the accounting truth that all economic expenditures should equal the entire income produced by the production of all economic products and services, the income approach to calculating gross domestic product was developed. It also presupposes that an economy has four main production elements and that each of these four sources must receive all income. Therefore, a rapid estimation of the overall productive value of economic activity throughout a time period can be made by adding up all of the sources of income. Taxes, depreciation, and foreign factor payments must then be adjusted. The beginning point of any strategy is a key distinction. The money used to purchase goods and services is where the expenditure approach starts. In contrast, the income approach begins with the money coming in from the creation of products and services wages, rents, interest, profits.

### **A Ceiling for GDP Measurements**

The purpose of GDP, which can be computed in a variety of ways, including the expenditure approach, is to assess the level of living and economic health of a nation. Many critics, including the Nobel Prize-winning economist Joseph Stiglitz, warn that GDP should not be regarded as a complete measure of a society's well-being since it excludes crucial elements that contribute to happiness. For instance, while private and public sector spending is included in GDP, these factors are not taken into account when determining work-life balance or the standard of interpersonal relationships in a particular nation.

### **Parts of the Final Expenditure**

The following constitutes the gross domestic product's final outlay:

- i. Private Final Consumption Expenditures:** These comprise purchases made by households and private non-profit organizations like clubs, schools, and other organizations.

- ii. **Government Final Consumption Expenditures:** These costs include those for administration, defiance, upholding the rule of law, and education, among other things. Is the sum of producer purchases of capital goods? It raises the economy's capital stock.
- iii. **Net Exports of Goods and Services:** Net exports are calculated by deducting the value of imported goods and services from the value of exported goods and services. Following is a quick explanation of the procedures to be followed when computing national income using the expenditure method:

Estimation of private final consumption expenditure: Retail prices for the volume of goods and services purchased are multiplied to determine final consumption expenditure by households and nonprofit organization's acting as households. Estimation of government final consumption expenditure: Since government services are provided at no charge to the government, government final consumption expenditure is computed in terms of the cost to the government. This is thus because the general government does not engage in market commerce. The amount of employee salary and the price of the goods and services the government purchases are the cost to the government. Therefore, government final consumption expenditures comprise staff compensation as well as the net worth of the products and services the government has acquired on the domestic and global markets. Gross domestic capital formation projection: It includes stock changes, plant and equipment purchases, and building expenditures.

Finding the value of net exports, or the export value minus the import value of goods and services, is the final phase. GDP is calculated at market prices as the total of gross domestic product, net exports, private and public final consumption expenditure, and gross domestic capital formation. Depreciation and net indirect taxes must be subtracted from GDP at market prices and added to it in order to obtain NNP at factor cost or national income. Taking precautions when estimating expenses following are the items that should be included and excluded when assessing national income using spending method:

- i. Because used items are part of the stock of products produced in the past, they shouldn't be included in expenditures.
- ii. Since shares, bonds, and other similar paper titles solely serve to demonstrate property ownership, expenses for their purchase should be excluded. The buying and selling of shares, bonds, etc. does not result in the production of any tangible goods.
- iii. Transfer payments like pensions, scholarships, unemployment benefits, etc. shouldn't be included in the calculation.
- iv. To prevent double counting, expenses for intermediate or semi-finished goods should be disregarded.

## Scope

The range of economic activities and factors that go into total spending in an economy are included in the measurement of national income using the expenditure approach. The following are the main elements that fall under the purview of the spending method: Measurement of household consumption spending is a component of the expenditure approach. Spending on products and services that people and families buy for their own use is included in this. Spending on necessities, non-durables, durables, and services are all included. Investment Expenditure Investment expenditure, which includes purchases of capital goods and increases to inventories, is taken into account using the expenditure approach. It includes both public and private investments in infrastructure and public capital formation, such as company investments in machinery, equipment, and buildings.

The scope of the expenditure technique includes all levels of government, including the federal, state, and municipal. Spending on public services and goods including healthcare, infrastructure development, defiance, and administrative services are included. Both government consumption and investment spending are taken into consideration. Net Exports Net exports, or the difference between the value of exports and imports, are included in the expenditure method. It accounts for both domestic expenditure on goods and services that are exported and domestic spending on goods and services that are imported and used domestically. Transfer payments are not included in the calculation of national income under

the expenditure method. As they don't actually represent spending on finished products and services, transfer payments include government transfers like social security benefits, welfare payments, and subsidies. Time Period the spending technique of measuring national income is often applied over a set time period, such as a year or a quarter. It enables comparisons and historical examination of economic trends and performance.

The time frame picked offers a picture of the entire amount of economic spending. Geographic limits the spending technique concentrates on economic activities that take place inside a particular geographic region, usually within a nation's borders. No matter the source of ownership it includes all domestic spending. It does not, however, include domestic entity spending that takes place outside of the nation. Informal Sector both the formal and informal sectors of the economy are included in the scope of the spending method. Recognizing that informal sector activities may not be fully accounted for due to limitations in data collection and reporting, it tries to cover expenditure in both sectors. Application of the National Income and Expenditure Measurement Method One way for calculating national income is the expenditure method, which totals the value of products and services that are purchased, invested in, exported, and spent by the government. The use of the expenditure technique to calculate national income yields a number of insightful results and serves a number of objectives. Here are a few crucial examples Aggregate Demand Assessment the spending technique aids in determining aggregate demand for goods and services within an economy. Policymakers and economists can learn more about the total level of demand and its makeup by examining expenditure components like consumption, investment, government spending, and net exports.

Understanding the forces that drive economic activity and creating effective strategies to control demand variations require the knowledge of this information. Consumption Pattern Analysis The spending approach enables the evaluation of consumption trends within an economy. Policymakers and businesses can learn more about consumer behavior, preferences, and spending patterns by researching household consumption expenditures. For market research, business planning, and the creation of focused marketing strategies, this knowledge is helpful. Detecting Investment Trends, the spending approach offers information on patterns and trends in investment. Policymakers and investors can gauge the intensity of investment activity in various industries by looking at gross fixed capital formation investment in tangible assets and changes in inventory. This data aids in locating investment possibilities, assessing the success of investment strategies, and encouraging profitable investment for economic expansion.

The expenditure approach enables the observation of public spending within a given economy. Policymakers can examine the efficacy of public programmers, pinpoint areas of government involvement, and determine how fiscal policies affect economic activity by looking at government consumption and investment expenditures. Planning a budget, allocating resources, and assessing the performance of the public sector all depend on this data. Analysis of Net Exports and Trade Balance The expenditure approach offers information on a country's net exports and trade balance. Policymakers and economists can evaluate the contribution of international commerce to the economy and assess the competitiveness of home sectors by taking into account the value of exports and subtracting the value of imports. For developing trade policies, promoting exports, and managing trade imbalances, this information is helpful.

The spending method enables analysis of national income and economic performance on a global scale. Policymakers and analysts can determine the relative weights of consumption, investment, government spending, and net exports in various economies by comparing the expenditure components across nations. Understanding global economic patterns, identifying regions of strength or weakness, and making knowledgeable choices regarding international commerce and investment are all made easier with the aid of this information. In conclusion, using the expenditure technique to calculate national income offers important new perspectives on factors including total demand, consumption trends, investment trends, government expenditures, trade balance, and global comparisons. These insights support businesses, analysts, and legislators in developing policies that will encourage economic growth, stability, and development. They also help businesses understand how the economy works.

### **User Benefits of the National Income and Expenditure Method:**

1. The expenditure approach of measuring national income has a number of benefits that help us understand the economy and make better policy decisions. Here are some major benefits of measuring national income using expenditures:
2. Detailed Evaluation of Economic Activity. The expenditure technique offers a detailed evaluation of economic activity within an economy. It captures a wide range of economic transactions by taking into account all expenditure components, including consumption, investment, government spending, and net exports. This enables economists and policymakers to have a comprehensive understanding of economic activity and its determinants.
3. Simple and Transparent Calculation. The expense technique has a calculus that is both straightforward and transparent. It includes adding up all of the different expense components to make it simple to comprehend and analyses. This method's simplicity makes it popular and makes it easier to make comparisons across different nations and throughout time.
4. Aggregate demand is captured. The spending technique makes it possible to gauge aggregate demand in an economy. Policymakers can assess the overall level of demand and its makeup by looking at consumption and investment spending. For controlling business cycles, spotting demand-side imbalances, and developing suitable fiscal and monetary policies, this knowledge is essential.
5. Reflects Consumption Patterns of Households. The spending technique sheds light on the habits of household consumption. Policymakers and businesses can better understand consumer behavior, preferences, and spending patterns by looking at consumption expenditures. For market research, business planning, and the creation of focused marketing strategies, this knowledge is helpful.
6. Investment Trends. Can Be Recognized Using the Expenditure Method An economy's investment trends can be recognized using this method. Policymakers and investors can evaluate the volume and distribution of investment activity by looking at investment expenditures. This data aids in locating investment possibilities, assessing the success of investment strategies, and encouraging profitable investment for economic expansion.
7. Government expenditures is Monitored the expenditure approach makes it easier to keep track of government expenditures. Policymakers can assess the success of public policies, monitor public sector performance, and ensure optimal resource allocation by looking at government consumption and investment expenditures. This data is essential for planning the budget, assessing policies, and ensuring transparency in public spending.
8. Analyses Trade Balance. By taking into account net exports, the spending technique sheds light on a nation's trade balance. Policymakers and economists can evaluate the impact of international commerce to the economy and gauge competitiveness in global marketplaces by comparing the value of exports and imports. This data aids in the creation of trade policy, the encouragement of exports, and the management of trade imbalances.
9. International Comparisons. The spending method enables analysis of national income and economic performance on a global scale. Policymakers and analysts can determine the relative importance of consumption, investment, government spending, and net exports by comparing the expenditure components across various nations. The identification of areas for policy development and cross-country analysis are made easier with the use of this information.

### **III. CONCLUSION**

An essential instrument in economics for determining the level of economic activity and comprehending the dynamics of an economy is the assessment of national income using the expenditure method. It provides insightful information on trade balances, government spending, investment trends, and consumption patterns. The main ideas surrounding the expenditure method's application to the calculation of national income are summed up in this conclusion. The expenditure technique offers a thorough framework for assessing the performance of an economy by taking into account various

spending factors. It enables analysts of household consumption patterns, investors, trackers of government spending, and economists to evaluate the significance of net exports. Making wise decisions, comprehending economic dynamics, and devising effective policies all depend on these insights.

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