

## CHAPTER TWO

### NATIONAL INCOME AND ECONOMIC POLICY

2.1. The economic policy of a nation is designed to assure the livelihood of its people, to prevent or mitigate declines in the nation's material product and to encourage vigorous economic growth; securing at the same time economic justice in the country, and peaceful relations with the rest of the world. In the under-developed regions of the world, the problems with which the state must particularly cope are starvation levels of output, due to natural or man-made calamities or to stagnant productive conditions, and gross inequalities that may arise because adverse circumstances and obstacles to greater productivity affect unequally various groups in society.

2.2. These problems, which are the compelling drives of economic policy in under-developed regions, fall with particularly severe impact upon some classes in the community. Popular pressures upon economic policy come, therefore, only from some specific groups, and the state ordinarily finds itself subject to a series of demands, generated by such groups, urgently calling for assistance. In such a situation, there is a tendency to deal with each specific problem as it arises; to overlook the interdependence of groups in a nation and the continuity of effects of any policy over time. When economic policy is pursued in such piecemeal and short term fashion, solution of the problems of one group may impinge adversely upon others; a given solution to-day may give rise to a worse problem tomorrow; and long term problems may be allowed to accumulate, with the danger that they will not be capable of solution within the existing framework of society whose preservation is sought.

2.3. Some problems are so urgent, and the cost of not meeting them so high, that economic policy must respond promptly and without close calculation of effects upon the rest of the community or upon the future. When famine strikes, or when the country's security is in danger, action must be taken without delay and without precise calculus. Yet even in such cases, there could be choice; and if the crisis is prolonged, there will be need for keeping the whole economy in view and to think of the future as well as of the present. In other problems, there is more room for weighing the costs to the rest of the society against the gain to the sector whose problem is being remedied. Above all, if the state is to act for the

community at large, a community that lives not only to-day but through its coming generations in the future, it must, in economic as well as in other policy, view the country's economy in all its ramifications and as a system that must increasingly satisfy both present and future needs. The relevance of what we have said above to this report is that national income statistics provide a wide view of the country's entire economy, as well as of the various groups in the population who participate as producers and income receivers; and that, if available over a substantial period, they reveal clearly the basic changes in the country's economy in the past and suggest, if not fully reveal, trends for the future.

2.4. National income statistics, estimates and accounts are often presented in a technical jargon, which, however useful to technicians, obscures the fundamental concepts whose understanding is important to all men of intelligence concerned with economic problems of their country. These concepts are as simple as they are basic.

2.5. A national income estimate measures the volume of commodities and services turned out during a given period, counted without duplication. The first important characteristic of such measures is their comprehensiveness; they include all economic activity, whether it be the production of shoes or of airplanes, services in the way of medical care or provision of justice. These measures, therefore, provide a total for the country's whole economy; and permit one to weigh the magnitude of any given sector, the product, expenditure or income of any group, against the corresponding national totals.

2.6. No national income estimate and account is, or can be, limited to a single figure covering the whole country's product or expenditure. Both because of requirements of proper bases of estimation and because of analytical needs, national income estimates or accounts attempt to distinguish the important groups in the economy: producers of various categories, whether agricultural cultivators, persons and firms engaged in manufacturing production, or individuals who render professional or administrative services. For each of these producing groups the estimates gauge the net product which their activities yield. Likewise, there is an attempt to distinguish various groups of income recipients, whether by the type of productive factor which their income represents (wage earners versus recipients of property income) or by size of their income. The distinction thus made among various groups of producers, income recipients, and if data are available, spenders, savers and taxpayers is of wide importance for both analysis and policy, since it permits one to view the country's

economy as a congeries of interrelated but distinct groups, differing with respect to the technology and pattern of their productive operations; level and structure of their income; and character of their expenditure and saving. The crux of the matter lies in the fact that these various groups will respond differently to various policy measures; and the effect of one and the same measure will differ as it is applied to the several groups.

2.7. Just as a set of national income estimates or accounts will distinguish significantly different industries or groups of producers and between type-of-payment or size-of-payment classes or different groups of income recipients, so will it also try to cover fully the several economic functions such as production, distribution and expenditure. In the circuit flow of economic activity the same total income can be measured at the point of production, as a sum of net outputs arising in the several industrial sectors of the nation's productive system; at the point of flow of incomes, as the sum of all incomes in cash, in kind and retained by enterprises as net profit; at the point of final utilisation, as the sum of consumers' expenditure, government purchases of goods and services, and net outlay on capital goods. The total of net outputs, income flows, and final expenditures, with allowance in each for flows across boundaries, will of course be identical; but the significance of each arises from the fact that they reflect the total operations of the nation's economy at the levels of the three basic economic functions, viz. production, distribution, and expenditure or consumption; and, at the several levels, the groups and components distinguished will be different, each illuminating the basic operations of the country's economy.

2.8. Several lines of interconnection run among the several operating sectors such as producers, distributors, consumers, etc., and the several functions which they perform. In the wide division of labour that exists in economic society, the productive activities of one group, e.g. of agricultural cultivators, affect the activities of another group of producers, e.g. of the manufacturing, transporting and trading units which handle the products of agriculture. Likewise, for any given producing unit, say a business firm or an individual, the amount of net output during the year determines the amount of income received, paid out or retained, as well as the amount consumed and saved. Since for groups of producers, output affects and determines their activities as distributors, consumers or savers, it shows that the interconnection of groups of producers via the markets means also their interdependence as income payers or receivers and as consumers and savers. These lines of interconnection among the several operating sectors

of a nation's economy, including its relation to the rest of the world, and among the several basic economic functions in which they are engaged, can be described most effectively through a system of accounts; in these the operating groups appear as transactors, and their several functions as types of transactions among transactors or between accounts. It is a great advantage of national income estimates and accounts that, in addition to giving a wide view of the whole economy and distinguishing the significant operating sectors and functions, they also emphasize the various lines of interconnection existing among the sectors and the functions.

2.9. National income estimates, therefore, constitute a quantitative measure, rather than a verbal description of the country's economic activity; as well as of the activity of the significant sectors of the country's economy. We have already stated that these estimates pertain to the net total, where one must avoid the double counting involved in including both the raw material and the commodity into which the raw material enters. The reduction of the numerous economic activities of the millions of people in a country to a common denominator that permits quantitative measurement is clearly beset with intellectual difficulties; how does one add together the services of a street sweeper with those of a prime minister, the product of a village carpenter with that of a steel mill? Likewise, getting at net product is far from an easy task; while it is clear that one should not count the full value of both the coal and the steel in whose production the coal was burned up, difficulties arise when one asks which part of the government's general administration is service to business firms, enters into the value of its product, and hence should not be counted, and which part is service to the people as individuals and consumers and should be counted.

2.10. It would be out of place to discuss these problems here; many learned texts have been written on their solution. They are mentioned here only to indicate that some basic judgments and social criteria are involved in the task of measuring a country's total net output. Yet this does not mean that the results are arbitrary, in the sense that they are subject to the caprice of the individual estimator. If a country's economy is an integrated system, if its various parts and sectors are inter-related, it must be operating on some common if only approximate yardstick—ordinarily provided by market prices. Hence reducing all activities to prices as the common denominator reflects a basic aspect of a nation's economy, and is not a mere whim of the estimator. Likewise, in considering what is consumption in the process of production and what is net

product, the estimator merely follows the judgment of society—which views net product as what is available either for consumption of individuals, personally or collectively, or for addition to capital stock.

2.11. National income estimates or accounts are, therefore, measures of the total net product of a country's economy, with distinctions among significant operating sectors and the several economic functions, all gauged on a consistent basis permitting quantitative measurement. These measures tell us how much the various sectors have produced, distributed, and consumed; and they tell it for the economy as a whole, without omission and without duplication.

2.12. The great usefulness of such measures, even if relating to only a single year, for any consideration of questions of economic policy is obvious enough—particularly if one remembers that in the process of arriving at such measures, a great deal of related information (e.g. on the number of workers, on the geographical distribution within the country, on gross income and expenses, etc.) is usually secured. Take a typical policy problem that arises, say that of imposing a retail sales tax in which the magnitude of possible collection has to be estimated and then a possible limitation to non-necessities considered. If one has at hand a customary component in national product estimates, measures of consumer expenditure by various categories (food, clothing, etc.), it should presumably be possible to approximate what different rates of taxes with different coverage would yield, since even a single year's figure gives an order of magnitude of the level of retail sales in a country. It is not argued here that information provided by national income estimates would be decisive in the policy question illustrated—only that it would permit a far more intelligent decision than would be possible otherwise. And what is true of the example cited would likewise be true, say, of questions of subsidy to certain industries (e.g. small scale or cottage industries), of tariffs, or wage rates, of facilities for investment, etc. In all these cases a well developed set of national income estimates and accounts, even for a single year, would yield basic facts of inestimable value for narrowing the range of conflicting conjectures and for permitting a more intelligent decision.

2.13. If detailed and consistent national income estimates are available for more than one year, their value increases more than proportionately. For then it becomes possible to have not only a cross-section of the nation's economy at a single point of time, but to compare and analyse changes in the output, income and expenditure of the various sectors;

and to study the responses of the various economic groups to the different conditions that may have characterised the several points of time covered. In such case, the income estimates yield not only the basic magnitudes but also knowledge of relations that are of the most value in appraising possible effects of changes introduced by economic policy. Thus to use the earlier illustration, it becomes possible not only to approximate the magnitudes of yield in case of a contemplated sales tax but also to try to evaluate the effects of such a tax on the disposition of consumers' incomes on the sales of taxed and untaxed categories, and perhaps even on saving; provided that the analysis of the past yield information as to how demand for consumer goods has changed in response to a rise in price. The point to be emphasized in this connection is that such use of national income estimates and related data involves not only availability of such data over periods comprising short term changes, but also economic analysis that goes beyond the mere presentation of data in tables and accounts.

2.14. Finally, if detailed and consistent national income estimates and accounts are available over a long period of the country's economic history, it becomes possible to appraise the trends in the country's economic growth; and by dint of analysis, associate these trends with various factors. Of particular importance is the possibility of appraising the long term response of the various groups and sectors in the nation's economy, responses that may be significantly different from those manifested by the same groups to short term impacts. For example, a long term change in income level clearly produces an entirely different adjustment of consumption expenditure and saving from a short term change. The bearing on economic policy is obvious. Even short term economic legislation should be appraised from the standpoint of the long term effects it may bring about. In fact many facets of a state's economic policy are of direct concern with and have impact upon the long term growth of a country's economy; more particularly, any systematic endeavours in the field of economic planning have primarily long term implications. It is, therefore, exceedingly important that some background of empirical knowledge and analysis exist relating to past growth of the economy, reflective of its patterns of adjustment to changes over the long run. The availability of long period data on national income and its components can therefore be exceedingly helpful in revealing the trend in the productivity of various industries, and the effects of capital investment upon them; the tendencies in the distribution of income among various population groups and the effects of such tendencies upon trends in the apportionment of income between consumption and saving; and many other dynamic

aspects of the economy—all indispensable for a proper thinking through of the country's feasible economic future and of the probable impacts of various economic policies designed to encourage economic growth.

2.15. The utility to economic policy of national income estimates and accounts, especially if enhanced by analysis serving to reveal the factors at play, needs no further stressing; it channels the mind of the policy maker away from the immediate pressures of the specific problems to a consideration of the whole economy, of the close interrelations among its parts, and of the links between the present and the future. But to avoid misunderstanding, it should be stressed that these statistical measures, no matter how revealing, do not in and of themselves yield determinate answers to questions of economic policy; nor will they do it completely, even when used in a framework of economic analysis. There would still be room for value judgments, based on social ideals and appraisals of political and administrative feasibility. Nevertheless, there can be no doubt that national income estimates and economic analysis thereof can form a useful base for intelligent decisions and can minimise, if not altogether eliminate the guesses and prejudices that so much underlie current policy judgments on economic issues. Securing proper data for national income estimates and the intellectual resources necessary for their analysis constitute a long and relatively costly task. If, in spite of this, we have laid so much stress on the utility of such data and the need for undertaking both their collection and analysis, it is because of our belief that policy makers in this country will make active use of this material, once it becomes available to them in a form visibly relevant to the many issues they handle.