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*CA Intermediate Group 2 – Paper 8*

*Financial management*

*&*

*Economics for Finance*

*Sec B - Economics for Finance*



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## Chapter 1: Determination of National Income

### Unit I: National Income Accounting

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#### 2 Activities:

Economic | Non – Economic

#### 4 Sectors:

Household | Firms | Government | Rest of the World

#### 2 Goods

Final | Intermediate

Final - 1. Consumption | Investment 2. Used for more than a year

Intermediate - 1. Resale | Further Production 2. Used in the same year

[Note: GDP includes Capital Goods & Inventory Investment]

Note: Inventory Investment: Goods produced this year, but sold later

#### 3 Territorial Sectors:

Primary | Secondary | Tertiary (Service)

Primary – Agriculture, Fishing, Forestry, Mining, .....

Secondary – Heavy & Light Manufacturing, Oil Refinery, Energy Production,

Tertiary (Service)

- Market (Trade, Transport, Real estate, Personal Services, .....

- Non – Market (Human health, Social Work, ....)

#### 3 Basic Incomes:

Labour | Capital | Mixed

Labour - Wages & Salaries, Fringe Benefits, Employer's Contribution to Social Security

Capital - Profit, Interest, Dividend, Royalty

Mixed – Farmers, Sole Proprietorship, Professionals

### **3 Incomes (as Macroeconomic aggregates / parameters):**

National Income | State Income | District Income

Domestic Income (Public & Private Sector)

Personal Income | Disposable Personal Income

Disposable National Income (Gross & Net)

Public Income | Private Income

### **3 Approaches / Sides / Methods - NI A/Cs:**

Product (w.r.t. Value Addition)

Income (w.r.t distribution of proceeds from sales to different factors)

Expenditure (w.r.t Final Sales of G &S)

### **2 Values:**

“ex – post” values | “ex – ante” Values

“ex – post” values – Realised Values (i.e. actual or accounting values)

“ex – ante” Values – Anticipated Values (i.e.intended or planned values)

### **Measures (product side)**

Gross : GDP | GNP

Net : NDP | NNP

Note:

Types of GDP

Nominal GDP – For Current Year

Real GDP – w.r.t Base Year | Inflation Adjusted | Comparisons @ different time periods

**Table A (GDP @ MP)**

		Resident / Citizen / Firm	
		Indian	Foreign
Production / Income	Indian	<b>GDP</b> Market Value ALL FINAL Economic Goods & Services Gross of Depreciation Produced within DOMESTIC TERRITORY of a country	
	Foreign	<b>NFIA</b> (GNP = GDP + NFIA)	-

**National Income, NNP (FC) = FID + NFIA**

Note:

1. NFIA – Net factor Income from Abroad

=  $\sum$  Foreign Income by Indian person in Foreign -  $\sum$  Foreign Income by Foreign person in Foreign

= Net Compensation of Employees + Net income from Property and Entrepreneurship + Net retained earnings

2. FID - Domestic Income (Factor income earned in domestic territory)

#### 4 Factors of Production:

Land | Labour | Capital | Entrepreneurship, to combine other factors

Land - yields Rent | Capital - yields Interest  
 Labour - yields Salaries & Wages | Entrepreneurship - yields Profit

**Table B 1** (GDP @ FC & MP)

	Compensation of Employee (C) (i.e. Salary)	xxx		
+	Operating Surplus(O) (Rent + Profit + Interest)	xxx		
+	Mixed Income of Self – Employed (M)	xxx		
+	Depreciation / Consumption of Fixed Capital (D)	xxx		
	<b>GDP (FC) = C + O+ M+ D</b>		xxx	NDP (@ FC) = GDP (@ FP) - D
+	All * Indirect Tax (I)	xxx		
-	All * Subsidy (S) * Internal Inputs, Labour, Capital (since already included in FC)	xxx		
	NIT = I – S		xxx	
	<b>GDP (MP) = GDP (FC) + NIT</b>		xxx	NDP (@ MP) = GDP (@ MP) - D
+	NFIA		xxx	
	<b>GNP</b>		xxx	

**Table B2** (All parameters in short)

	<b>GDP (FC)</b>	xxx	<b>NDP (@ FC)</b> = GDP (@ FC) - D
+	NIT = I - S	xxx	
	<b>GDP (MP)</b>	xxx	<b>NDP (@ MP)</b> = GDP (@ MP) - D
+	NFIA	xxx	
	<b>GNP</b>	xxx	

Note:

1. For Gross → Net: Deduct Depreciation
2. For DP → NP: Add NFIA

**Table B3: National Income**

	<b>GDP (MP)</b>		xxx
-	Depreciation	xxx	
	<b>NDP (MP)</b>		xxx
-	NIT	xxx	
	<b>NDP (FC)</b>		xxx
+	NFIA	xxx	
	<b>National Income – NNP (FC)</b>		xxx



### 3 Types of Prices:

Market Price | Factor Price | Basic Price

**Table C**

				paid / received
	GDP (FC)		xxx	
+	Production Tax	xxx		Land Revenues, Stamps and Registration Fees, Tax on Profession, Factory License Fee, Tax – Local authorities, Pollution Tax, .....
-	Production Subsidy	xxx		w.r.t Railways, Village and Small Industries
	GDP (BP)		xxx	* only related to intermediate inputs (others are deducted)
+	Product Tax	xxx		Excise Duty, Sales Tax, Service Tax & Import and Export Duties
-	Product Subsidy	xxx		w.r.t Food, Petroleum and fertilizers
	GDP (MP)		xxx	

### 3 Methods: Value Method | Income Method | Expenditure Method

**State in India:** Calculation of Net Value Added for

Agri Sector – Product Method

Small Scale Sector – Income Method

Construction Sector - Expenditure Method

#### 1. Value Added Method: [Product / Industrial Origin / Net Output Method]

Suitability:

Importance: Unduplicated contribution by each industry to the total output

**Table D**

	<b>Sales</b>		xxx
+	Closing Stock	xxx	
-	Opening Stock	xxx	
+	<b>Changes in stock</b>	xxx	xxx
-	Intermediate Consumption	xxx	
	<b>GVA / GDP (MP)</b>		xxx
	<b>National Income (Follows from Table B3)</b>		xxx

Note:

1. Value of Output = Gross Value of Output (w.r.t Labour & Capital)

2. Include:

- Own account Production of fixed assets by Government, Enterprises & Households
- Imputed value of production of goods for self – consumption
- Imputed rent of owner - occupied houses

3. Hints for calculation Purpose: Consider

- Every main economic sectors (Primary | Secondary | Manufacturing | Quaternary)
- The net products contributed by each and every sector & Sub-sector are included

## 2. Income Method: Factor Income / Factor Payment / Distributed Share

Suitability: For developed Countries where people properly file their IT returns

Includes: Factor Payments of Residents & Non – Residents within the territory

$$\text{NNP(FC) / NI} = \text{NDP (FC) + NFIA}$$

or

**Table E (Similar to Table B1)**

	Compensation of Employee (C) (i.e. Salary)	xxx	
+	Operating Surplus(O) (Rent + Profit + Interest)	xxx	
+	Mixed Income of Self – Employed (M)	xxx	
+	Depreciation / Consumption of Fixed Capital (D)	xxx	
	<b>GDP (FC) = C + O+ M+ D</b>		xxx
+	All * Indirect Tax (I)	xxx	
-	All * Subsidy (S) * Internal Inputs, Labour, Capital (since already included in FC)	xxx	
	NIT = I – S		xxx
	<b>GDP (MP) = GDP (FC) + NIT</b>		xxx
	<b>National Income (Follows from Table B3)</b>		xxx

**Note:**

Inclusions	Exclusions
<p>Imputed value</p> <ul style="list-style-type: none"> <li>- Rent for self – occupied houses or offices</li> <li>- Services provided by owners of production units (family labour)</li> </ul> <p>Labour Income:</p> <p>Wages &amp; Salary, Bonus, DA, Commission, Brokerages, Employer’s contribution to PF, imputed value of compensation</p> <p>Non – Labour Income:</p> <p>Rent(Actual &amp; Imputed), Royalty, Interest on loans availed for productive services, dividends, undistributed profits of corporations b/f tax, Profits of unincorporated enterprises and of Government enterprises</p>	<p>Transfer Payments (pension, Social Insurance) (as not received for any services in the current Year)</p> <p>Receipts of Sale of 2<sup>nd</sup> hand goods (as no new flow of goods)</p> <p>Windfall gains (Lotteries) (Not receipts from any productive activity)</p> <p>Corporate Profit (Not to be separately included as already included as part of company profit)</p> <p>Capital Gains</p> <p>Financial assets &amp; payments out of past savings</p> <p>Interest paid on Public Debt, Consumption Loans, by one firm to another</p>

Profit = Corporate Tax + Dividend + Retained Earnings

Note:

Hints for calculation Purpose: Includes

Income from people in jobs and in self employment (e.g. wages & salaries)

Profits of private sector business

Rent income from the ownership of land

### 3. Expenditure Method (w.r.t. Aggregate Demand):

Income Disposal Approach / Outlay Method

Suitability: Growing facility in the use of the commodity flow method of estimating expenditures, an increasing proportion of the NI is estimated using this method

**GDP (MP) = Sum of Final Expenditure**

**Table F**

	Private Final Consumption Expenditure – C	xxx	
+	Government / Public Consumption Expenditure – G	xxx	
+	Gross Domestic Capital Formation - I	xxx	
+	Net Exports – (X - M)	xxx	xxx
	<b>GDP (MP) = C + G + I + (X - M)</b>		xxx
	<b>National Income (Follows from Table B3)</b>		xxx

Overall Note:

- All the method should arrive equal value
- 3D View
- Measurement Errors (all the methods compliment each other)
- Different Methods gives different insights into structure of our economy

**Table G: PI & DPI**

	<b>National Income (NI)</b>	xxx
- Income Earned but not received	Undistributed (Corp) Profits Net interest Payments made by households to Frims & Governments Corporate (Profit) Tax Income from Property & Entrepreneurship accruing to Govt administrative departments Income from Domestic Product accruing to Govt Saving of Non-departmental enterprises, Private corporate sector Contribution of employees to social security	xxx
+ Income Received but not Earned	Transfer payments to the households from firms & Governments Current Transfer from Firms, Govt & Rest of the world (Ex: Net private donations) Interest on National Debt	xxx
	<b>Personal Income (PI)</b>	xxx
-	Personal Income Tax (Direct Tax, ....) Non - Tax Payments (Compulsory payments to Governments like PF, .....)	xxx
	<b>Disposable Personal Income (DPI)</b>	xxx

Note:

1. Transfer Payments: Social Security | unemployed compensation | Welfare Payments
2. PI excludes: Retained Earnings | Corporate Tax | IDT (business)
3. Social Transfers (Pension, Relief subsidy)
4. DPI
  - Consumption + Saving
  - w.r.t Individuals | available for consumption
  - NNDI & GNDI reflects the amount of G & S the domestic economy has at its disposal

**Table H: NNDI & GNDI**

	<b>Net National Income (NNI)</b>	xxx
+	Net Taxes on income and wealth receivable from abroad	xxx
Net Current Transfers from the rest of the world (Receipts – Payments)	Net social Contributions & benefits receivable from abroad	
	<b>Net National Disposable Income (NNDI)</b>	xxx
+	Depreciation (CFC)	xxx
	<b>Gross National Disposable Income (GNDI)</b>	xxx

Note:

1. GNI / GNP – Dep = NNI
2. Current Transfers – Current Transfers other than the Primary Income

## Domestic Income:

Public Sector | Private Sector

Public Sector – Includes \*(Income from Property & Entrepreneurship accruing to government administrative departments & Savings of non – departmental enterprises)

Private Sector:

**Table I**

	<b>NDP (FC)</b>	xxx
-	Income from Property & Entrepreneurship accruing to Government administrative departments	xxx
	Savings of non – departmental enterprises	xxx

## Private Income

- The income which accrues to a private sector from all sectors within & outside the country

- Includes Factor & Transfer Income

**Table J**

	<b>NDP (FC)</b>		xxx
-	Income from Property & Entrepreneurship accruing to government administrative departments	xxx	
-	Savings of non – departmental enterprises	xxx	
	<b>Factor Income from NDP accruing to private Sector</b>		xxx
+	NFIA	xxx	
+	National Debt Interest	xxx	
+	Current Transfers from Government	xxx	
+	Other net transfer from the rest of the world	xxx	
	<b>Private Income</b>		xxx

### Note:

Non – Departmental Enterprises: Separated from Government

Examples: Steel Manufacturing | Oil Exploration | Electricity Generation | FIs, .....



Misc...

Stock – A Quantity of a commodity that is constant at a point of time (Static)

Flow – Variables measured over a period of time

PQLI – Better indicator of Economic welfare than NI

NI should include loss of natural resources

Purchasing Power Parity (PPP) Method rather than US \$

National Income

- A Macro Economic Aggregate

- Equals to the Value of Aggregate Supply

GDP Deflator / Price Index =  $(\text{Nominal GDP} / \text{Real GDP}) * 100$

(NI (@ Constant Price = NI (@Current Price / (P1/P0))

Inflation Rate =  $(\text{GDP Deflator @ nth year} - \text{GDP Deflator @ n-1 th year}) / \text{GDP}$

Deflator @ n-1 th year \* 100

More on GDP:

Includes	Excludes
Service fee	Transfer Payments
Capital Goods (Business Plant and Equipment Purchased)	Financial Transactions
Inventory Investment	Non-reported output (illegal activities)
	w.r.t. Intermediate Goods

GDP per capita / per capita income =  $\text{Real GDP} / \text{Total Population}$

per capita State income =  $\text{NSDP} / \text{Mid - Year projected State Population}$

Note:

1. NSDP = State Income

2. State Income is not duplicated

## Annexures

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### A1 – Abbreviations

CFC	-	Consumption of Fixed Capital
DP	-	Domestic Product
DPI	-	Disposable Personal Income
FC / FP	-	Factor Cost / Factor Price
FID	-	Factor Income earned in Domestic Territory
GDP	-	Gross Domestic Product
GNDI	-	Gross National Disposable Income
GNP	-	Gross Net Product
NDP	-	Net Domestic Product
NFIA	-	Net Factor Income from Abroad
NI	-	National Income
NIT	-	Net of Indirect Taxes
NNDI	-	Nat National Disposable Income
NNP	-	Net National Product
NP	-	National Product
M	-	Import
MP	-	Market Price
X	-	Export
X – M	-	Net Exports