Q: Write a note on National Income accounting for an Open Economy.

Ans: An open economy refers to an economy where people and businesses can freely trade in goods and services with other countries. There are several benefits of an open economy**.** In an open economy, the GDP is the market value of all finished goods and services produced in a country within a specific period of time. There are several approaches to calculating the GDP. The most common approach is the expenditure approach that divides the GDP into household consumption (C), investment (I), government purchases (G), and net exports (NX). Hence, you can express GDP as follows:

$$\text{GDP or } Y = C + I + G + NX$$

This expression of GDP is called the national income identity for an open economy.

C = Consumption refers to household expenditure on various goods and services. Goods are of three types: non-durables (such as food and cloth), durables (such as cars and refrigerators) and services (such as haircut, education and medical care).

I = Investment refers to capital goods, which are purchased for producing mainly consumer goods in the economy (although, in reality, machines are also used to make machines). It may be noted, at the outset, that investment does not include purchases of shares and bonds, which just reallocate existing assets among different individuals. Investment refers to expenditure on new capital, which can be used in the future.

G = Government purchases are the various goods and services purchased by the central, state and local governments (such as municipalities and panchayats) such as food, books, stationery, railway wagons, and medicines as also services of government workers. For example, when an individual is working in a nationalised bank, the government is buying his service by paying him salary.

Government purchases does not include transfer payments made to individuals, such as pensions, interest on government bonds, unemployment benefit, etc. Those who receive such transfer payments do not provide anything to the government in exchange.

NX = Net exports are the difference between exports and imports. It is the difference between the value of goods and services exported to the rest of the world and the value of goods and services imported from the rest of the world. They represent the net exports by foreigners on domestically produced goods and services. Such income generates income for domestic producers. Imports have to be deducted from the identity because imports, in most forms, are usually included in the consumption, investment, and government purchases components. Thus if imports are not deducted, the GDP would be incorrect.

Thus, national income is the sum-total of income earned by the people of a country through their contribution to the production process. It not only includes income earned within the domestic territory of a country but also any income earned abroad.

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