

## Quadrant II – Transcript and Related Materials

**Programme:** Bachelor of Commerce (Second Year)

**Subject:** Indian Economy

**Paper Code:** CEG 104

**Paper Title:** Indian Economy

**Unit:** 02

**Module Name:** Per Capita Income

**Module No:** 10

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### Notes

#### INTRODUCTION

Due to limitations of national income as an indicator of development, economists like Rostow, Baran and Leibenstein etc. favoured the use of per capita income as an index of development. The UN experts in their report on, “Measures of Economic Development of Underdeveloped Countries” have also accepted this criterion. Broadly speaking per capita income refers to the real national income divided by the total population of the country.

If the rate of population surpasses the rate of national income growth, then per capita national income will fall. Similarly if both national product and population grow at the same rate, per capita national product will remain constant. This is not economic development. Therefore it is not rise in real national income but rise in real per capita income which may be taken as an indicator of development. Hence there is the urgent need to check the growth rate of population and to accelerate the rate of national growth, particularly in underdeveloped countries so that the real per capita income will rise.

#### MEANING

Per capita income is a measure of the amount of money earned per person in a nation or geographic region. Per capita income can be used to determine the average per-person income for an area and to evaluate the standard of living and quality of life of the population. Per capita income counts each man, woman, and child, even newborn babies, as a member of the population. This stands in contrast to other common measurements of an area's prosperity, such as [household income](#), which counts all people residing under one roof as a household, and family income, which counts as a family those related by birth, marriage, or adoption who live under the same roof.

## **CALCULATION**

Per capita income refers to the real national income divided by the total population of the country.

India's per-capita monthly income is estimated to have risen by 6.8% to Rs 11,254 during 2019-20. In 2018-19, the monthly per-capita income had stood at Rs 10,534.

## **USES**

- Perhaps the most common use of income per capita is to ascertain an area's wealth or lack of wealth. For example, income per capita is one metric the U.S. Bureau of Economic Analysis (BEA) uses to rank the wealthiest counties in the United States, the other being median household income.
- Per capita income is also useful in assessing an area's affordability. It can be used in conjunction with data on real estate prices, for instance, to help determine if average homes are out of reach for the average family.
- Useful to understand feasibility of setting up businesses. Businesses can also use per capita income when considered opening a store in a town or region. If a town's population has a high per capita income, the company might have a better chance at generating revenue from selling their goods since the people would have more spending money versus a town with a low per capita income.

## **IMPORTANCE**

### **(1) Stability and Wealth Measurement**

In the broadest sense, per capita income matters because it serves as a measurement of the stability and wealth within an economy. Per capita income is a ratio of the amount of all a region's income divided by its population. Thus, if the ratio rises, it suggests that members of the population are more prosperous than they have been in the past. Conversely, a reduced per capita figure suggests that the standard of living in a region has decreased, assuming the price of goods has either stayed the same or increased with inflation.

### **(2) Determination of Regions Needing Aid**

Because per capita income is a measurement of prosperity for a region, an advantage of per capita income is it can help you discover regions are in need of financial assistance, assuming that the cost of living is the same in those regions.

For instance, if the cost of rice is a dollar in country Y, but two dollars in country X, and country X's per capita income is higher, members of country X may be just as prosperous as those in country Y. If country X has the same per capita income as country Y, then the higher cost of rice would be an issue. If per capita income is the same, agencies that provide aid or financial assistance to those in country X, because members of country X would be financially worse off.

### **(3) Investment Uses of Per Capita Income**

A higher per capita income represents higher purchasing power, as members of the community have more money to spend. This is useful as it guides decisions regarding investments. For instance, in a new business, you would want to approach shareholders who can actually afford to invest. Otherwise, you would waste resources trying to market your company to people who will not back you financially.

Additionally, investing in businesses in areas with higher per capita ratios may yield a higher return, as the income of the area suggests that people have the purchasing power to buy the business's products or services.

## **LIMITATIONS**

Although per capita income is a popular indicator of development, it does have some limitations.

### **(1) Livings Standards**

Since per capita income uses the overall income of a population and divides it by the total number of people, it does not always provide an accurate representation of the standard of living. In other words, the data can be skewed, whereby it doesn't account for income inequality.

For example, let's say a town has a total population of 50 people who are earning \$500,000 per year, and 1,000 people earning \$25,000 per year. We calculate the per capita income as  $(\$500,000 * 50) + (1,000 * \$25,000)$  to arrive at \$50,000,000 in total income. When we divide  $\$50,000,000 / 1,050$  (total population), the per capita income is \$47,619 for the town.

However, the per capita income doesn't give us a true picture of the living conditions for all of those living in the town. Per capita income does not reflect the standard of living of the people. Per capita income is an average and this average may not represent the standard of living of the people, if the increased national income goes to the few rich instead of giving to the many poor. Thus unless national income is evenly distributed, per capita income cannot serve as a satisfactory indicator of development.

### **(2) Inflation**

Per capita income doesn't reflect inflation in an economy, which is the rate at which prices rise over time. For example, if the per capita income for a nation rose from \$50,000 per year to \$55,000 the next year, it would register as a 10% increase in annual income for the population. However, if inflation for the same period was 4%, income would only be up by 6% in real terms. Inflation erodes the purchasing power of the consumer and limits any increases in income. As a result, per capita income can overstate income for a population.

### **(3) Savings and Wealth**

Per capita income does not include an individual's savings or wealth and is thus not accurate. For example, a wealthy person might have a low annual income from not working but draws from savings to maintain a high-quality standard of living. The per capita metric would reflect the wealthy person as a low-income earner.

#### **(4) Children**

Per capita includes children in the total population, but children do not earn any income. Countries with many children would have a skewed result since they would have more people dividing up the income versus countries with fewer children.

#### **(5) Economic Welfare**

The welfare of the people isn't necessarily captured with per capita income. For example, the quality of work conditions, the number of hours worked, education level, and health benefits are not included in per capita income calculations. Although an increase in output per head is in itself a significant achievement, yet we cannot equate this with an increase in economic welfare. Let alone social welfare without additional considerations. Since development is multidimensional education, health, work-leisure ratio etc. are important considerations which do not get reflected in per capita income. As a result, the overall welfare of the community may not be accurately reflected.

### **CONCLUSION**

Even though there are many good uses of per capita income, it is only useful when there is a relatively low number of very high or very low earners in the community. These outliers could create biased per capita income results that do not represent the area accurately. Additionally, because per capita figures do not tell you how income is distributed, it can mask social issues, which cause the average income in those regions to rise or fall.

### **REFERENCES**

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