**CONCEPT:** CALCULATING GDP USING THE INCOME APPROACH

● ***Gross Domestic Product (GDP)*** is the value of the final goods and services produced by a country during a year

- □ GDP can be calculated by adding up all the ***expenditures*** during the year and has ________ main components
  - > Note that GDP can also be calculated by adding up all the ***income*** during the year (less common)
  - > They produce the same result because all the income earned is equal to all the expenditures made

● The ***income approach*** starts by adding up all components of ***national income***:

- □ *Compensation of Employees*: wages and salaries paid by businesses and government to employees
  - > The largest part of national income
- □ *Rents*: income received by landlords on rented properties (residential and business)
  - > Net rental income = Gross Rental Receipts – Depreciation of Rental Property
- □ *Interest*: income earned on loans by banks and depository savings by households
- □ *Proprietors' Income*: profits earned by sole proprietorships, partnerships, and other unincorporated businesses
- □ *Corporate Profits*: profits earned by corporations
  - > *Corporate income taxes* are part of GDP because they are earned by the government
  - > *Dividends* are profits paid out to stockholders
  - > *Undistributed Corporate Profits* are retained earnings used to re-invest in the corporation
- □ *Taxes on Production and Imports*: any general taxes levied by the government
  - > Taxes are included in GDP Income because Government Purchases are included in GDP Expenditures

● National income is then ***adjusted*** to reflect GDP:

- □ *Net Foreign Factor Income*: GDP measures "domestic" income
  - > We must remove income earned by Americans for supplying resources abroad
  - > We must add income earned by foreigners for supplying resources to the United States
- □ *Consumption of Fixed Capital*: Depreciation on long-term assets (such as equipment that lasts several years)
- □ *Statistical Discrepancy:* basically an error adjustment made by the accountants ($209 billion in 2009!)

2009 Accounting Statement for the U.S. Economy (in billions)

| Gross Domestic Product: Expenditures Approach | | Gross Domestic Product: Income Approach | |
|---|---|---|---|
| Sum of: | | Sum of: | |
| Personal consumption expenditures (C) | $10,089 | Compensation of employees | $7,792 |
| Gross private domestic investment ($I_g$) | 1,628 | Rents | 268 |
| Government purchases (G) | 2,931 | Interest | 788 |
| Net exports ($X_n$) | (392) | Proprietors' income | 1,041 |
| | | Corporate profits | 1,309 |
| | | Taxes on production and imports | 1,090 |
| | | Equals: | |
| | | ***National Income*** | **$12,288** |
| | | Adjustments: | |
| | | Less: Net foreign factor income | (105) |
| | | Plus: Consumption of fixed capital | 1,864 |
| | | Plus: Statistical Discrepancy | 209 |
| Equals: | | Equals: | |
| ***Gross Domestic Product*** | **$14,256** | ***Gross Domestic Product*** | **$14,256** |

*Source: Bureau of Economic Analysis*, www.bea.gov