

Constructing & Deconstructing GDP

The Income Approach

For use with Mankiw chapter 23

“Building Up” Method

- Here we will construct GDP according to the Income Approach
- We will add (and sometimes subtract) each component to achieve our GDP
- The Income Approach, while more accurate than the Expenditure Approach, is more time consuming resulting in a lag between reporting and full calculation of GDP

Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- The amount of income that households have left over after paying their personal taxes.
- They are free to divide that income between Consumption (C) and Savings (S)
- $DI = C + S$

Disposable Income

+ Compensation of Employees

- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Wages and salaries paid by businesses and government to their employees
- Includes wage and salary supplements such as payments by employers into social insurance and a variety of or private pension, health, and welfare funds for workers

- The largest part of GDP

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Disposable Income

+ Compensation of Employees

- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Part of *corporate profits* that are paid to corporate stockholders and thus flow to households (the ultimate owners of all corporations)

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Disposable Income

+ Compensation of Employees

- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- The net income of sole proprietors, partnerships, and other unincorporated businesses.

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Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Money paid by private businesses to the suppliers of money capital (loans and bonds)
- Interest households receive on savings deposits, certificates of deposit (CDs), and corporate bonds

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Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Income received by households and businesses that supply property resources
- Includes monthly payments made by tenants to landlords and lease payments corporations pay for the use of office space
- The figure here is *net rent* (gross rental income minus depreciation of rental property)

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Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- A payment of money (or goods and services) by government to a household or firm for which the government receives no good or service directly in return
- Includes the payment of Social Security benefits, welfare payments, veterans' benefits, and unemployment compensation

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Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Taxes on individuals
- The largest of these are personal income taxes
- This is deducted because it is money a household does not have at its disposal to spend

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Disposable Income

- + Compensation of Employees
- + Dividends
- + Proprietors' Income
- + Interest
- + Rent
- + Transfer Payments
- Personal Taxes
- Social Security Contributions

DISPOSABLE INCOME

- Mandatory deductions from income to Social Security and Medicare as per FICA (Federal Insurance Contributions Act)
- Also a deduction from the totals above

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Personal Income

DISPOSABLE INCOME

+ Personal Taxes

PERSONAL INCOME

- Includes all income whether it is earned or unearned
- Includes income that is earned but not received (such as Personal Taxes)
- $PI = DI + \text{Personal Taxes}$

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National Income

PERSONAL INCOME

- + Corporate Income Taxes
- + Undistributed Corporate Profits
- + Social Security Contributions
- Transfer Payments

NATIONAL INCOME

- Includes all income earned through the use of land, labor, capital, and entrepreneurial talent whether at home or abroad

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National Income

PERSONAL INCOME

- + Corporate Income Taxes
- + Undistributed Corporate Profits
- + Social Security Contributions
- Transfer Payments

NATIONAL INCOME

- Corporate Income Taxes are levied on net earnings and are counted as income (but not profits)

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National Income

PERSONAL INCOME

- + Corporate Income Taxes
- + Undistributed Corporate Profits
- + Social Security Contributions
- Transfer Payments

NATIONAL INCOME

- Money from income saved by corporations to be invested at later in new plants and equipment
- Also called *retained earnings*

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National Income

PERSONAL INCOME

- + Corporate Income Taxes
- + Undistributed Corporate Profits
- + Social Security Contributions
- Transfer Payments

NATIONAL INCOME

- Added back into the equation because it is money paid out of income by households to the government

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National Income

PERSONAL INCOME

- + Corporate Income Taxes
- + Undistributed Corporate Profits
- + Social Security Contributions
- Transfer Payments

NATIONAL INCOME

- Not included here because it is not earned for the contribution of the factors of production

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Net Domestic Product

NATIONAL INCOME

- + Indirect Business Taxes
- + Net Foreign Factor Income

NET DOMESTIC PRODUCT

- Measures total output but does not account for wearing down capital (depreciation)

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Net Domestic Product

NATIONAL INCOME

+ Indirect Business Taxes

+ Net Foreign Factor Income

NET DOMESTIC PRODUCT

- Examples include sales taxes, excise taxes, business property taxes, license fees, and customs duties
- These are taxes paid by the consumer and therefore show up in Consumption Expenditures
- This was part of the income earned by the household for its contribution to production

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Net Domestic Product

NATIONAL INCOME

+ Indirect Business Taxes

+ Net Foreign Factor Income

NET DOMESTIC PRODUCT

- The amount of income earned by foreign use of US resources minus income earned by American use of foreign resources.

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Gross Domestic Product

NET DOMESTIC PRODUCT

+ Depreciation

GROSS DOMESTIC PRODUCT

- The total value of all final goods and service bought and sold in the US for a given time period

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Gross Domestic Product

NET DOMESTIC PRODUCT

+ Depreciation

GROSS DOMESTIC
PRODUCT

- Also known as *consumption of fixed capital*
- An estimate of the wearing down of machinery and tools over time
- Represents the investment businesses make in replacing and repairing worn out equipment

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