SECTION 6.3 THE INCOME APPROACH TO MEASURING GDP

- Another way to measure GDP is the **income approach**, where the incomes received by producers of goods and services are summed. When someone makes an expenditure for a good or service, someone receives the money spent, and that receipt of funds is called income.
- Therefore, by adding up all of the incomes received by producers of goods and services, we can calculate the gross domestic product, because the sale of output creates income of equal value.
- Incomes received by persons providing goods and services are actually **factor payments** to the owners of productive resources. These payments include wages for the use of labor services, rent for land, payments for the use of capital goods in the form of interest, and profits for entrepreneurs who put labor, land and capital together. They totaled $1223 billion in 2010.
- We need must make two adjustments to **net domestic income at factor cost** (the total cost of factor payments) to arrive at GDP (the total value of output). The first adjustment is to adjust for indirect subsidies and taxes. We need to add indirect taxes (sales taxes, excise taxes, GST) because the amount of taxes is included in the value of output but is not paid to the factors that produced it. Similarly, we need to subtract the value of indirect subsidies (subsidies to farmers, aircraft manufacturers) because they represent factor income that would not be included in prices. In 2010, indirect taxes less subsidies totaled $173 billion.
- The second adjustment is to add **depreciation**, an estimate of the value of equipment that is used up in production. This is a cost of production and therefore will be included in the market price, but is not a payment to a factor input. In 2003, depreciation totaled $229 billion.

Exhibit 1 *2010 Canadian GDP by Type of Income*

- **Personal Income** measures the amount of income people receive, rather than the income they earn, because the income received reflects the amount available for spending, including transfer payments and before taxes.
- **Disposable Income** is the income available to individuals after taxes.