Income Approach

Income approach is the measurement of output on income earned by owners of factors by providing factors to the production process during a certain period.

What is calculated under the income approach is not all the income of an economy, but factor income only.

The method of using income approach practically for the calculation of the gross domestic product of a country is studied in this section.

Calculation of Domestic product under the Income approach

All income would not be included in the calculation of domestic product under the income approach. It is important to obtain comprehension about overall income generation of an economy in order to identify which income is included and which is excluded in that process. Income can be shown, divided into two parts, as follows:-

1. Unearned Income

Unearned income is income obtained without employment of factors. These are also called income received without earning.

Eg: Transfer income

No new income flow is generated by this income, and since only redistribution occurs. Therefore this income is excluded in national Accounts computations.

2. Earned Income

This is income earned by providing factors, services or other services to the production process by different sections of the economy.

Eg: Salaries income earned by supplying labour.

Taxes levied by the state for various services provided.

Such income creating new income flow represents value additions. These are considered in the computation of gross domestic product.

There are several types of income generated in a production process; such types of income generated are identified as primary income.

Primary Income

Primary income represents earnings due to the contribution of institutional units to the production process or for the provision of financial assets.

1. Compensation for Employees

Income earned by employees by providing labour for the production process. The following are included in it.

Financial allowance

Salaries and wages lodging allowance, travelling expenses distress allowance compensation.

Material allowance

Food, health facilities, transports services.

Social security payments provided by the employer provided fund, Retirement scheme, and insurance services.

2. Operating surplus

Operating surplus refers to the income generated by the corporate sector.

i. Leasing rent income

Leasing rent income is a mixed income received for both land and capital invested for development of land.

Eg:
- Agricultural land and leasing rent of natural resources.
- Houses and annual lease rent of other buildings.
- Intellectual property (copyrights, payments for plants publication rights) and received income also come under leasing rent.

ii. Interest payable to creditors who provide financial assets.

Interest is the payments by the business sector for persons who have supplied financial capital. What is considered here is only interest paid for loan funds that contribute towards creation of value addition.

Payment of interest funds that do not contribute towards creation of value addition are excluded in computation of national income.

Eg: Interest on loans taken for consumption.

iii. Corporate profit

Corporate profit is profit earned by incorporated business organizations.

This profit consists of three parts.

- Corporate income tax
- Dividends paid to owners of corporates.
- Retained profits of business (undistributed profits)

3. Net taxes on production and imports

Revenue from net taxes on production and imports as well as subsidies granted on production and imports are considered as primary income of the government.

4. Mixed income

Income generated by the use of household labour for production activities.

Eg: Net income of farmers

This becomes a mixed income because it includes income for all the factors, namely, capital, labour, land and entrepreneurship and all are provided by the owner himself.

Calculation of gross domestic product t marked price according to income approach.

Gross domestic income at market price can be calculated as follows according to income approach.

- Employee income	xxx
- operating surplus	xxx
- Mixed income	xxx
- Net tax on production and imports	xxx
Gross domestic income	**xxx**

Gross National Income

Gross national income is arrived at after adjustment of net foreign primary income to gross domestic product.

Gross National Income = Gross Domestic Product + Net foreign Primary Income

Gross National Disposable Income

Gross National Disposable Income = Gross National Income + Net Foreign Current Transfers

Household Income

Household income is the total amount of income received by households for the supply of factors of production.

Two main adjustments have to be made to gross national income to obtain household income.

01. Income not flowing to households should be excluded.

    Eg:
    - Social security contributions
    - Corporate profit taxes
    - Government property income
    - Depreciation

02. Transfer incomes received by households should be included.

    Eg:
    - Pensions
    - Grants given with welfare objectives
    - Foreign personal transfers.

Household Income = Net National Income + Household Transfer Receipts - Income Not flowing to households

Household disposable income

Household disposable income is the income that can be consumed at own discretion out of total income received by households. That is, the income that can actually be used to purchase goods and services to households [household consumption] The disposable personal income can be obtained by deducting personal income tax from the household income.

Disposable household Income = Household Income - Household Direct Tax

Eg: 01. Assume that the following data is provided to you relating to hypothetical economics.

Items Value in	**Rs. billions**
Salaries, wages and other additional labour income [Employee Income]	550
Indirect taxes	120
Subsidies	30
Farmers' income	20
Depreciation	60
Interest and other investment income	90
Business income other than from farms and corporate	70
Corporate Profits	80

Calculate the gross domestic product of this economy.

Answer

		Rs. Billions
Employee income		550
Mixed income (70+20)	90	
Net operating surplus (80+90)	170	
Depreciation	60	320
		870
Taxes on production – subsidies (120-30)		90
Gross domestic product		**960**

02. A set of macro-economic data relating to a hypothetical economy is set out below,

	(All the figures are in Rs. billions)
Salaries and wages	400
Personal Income tax	310
Net income of farmers	27
Interest Income	38
Government Transfer payments	240
Corporate profit taxes	40
Undistributed company profit	15
Net income earned from self-employment	30
Net foreign primary income earnings	20

Calculate the following;

(i) Calculate the National Income

(ii) Calculate the Disposable Household Income

Answer		**Rs. Billions**
(i) National Income		
Employees income		400
Interest Income		38
Corporate profits (40+15)		55
Mixed income (30+27)		57
Gross domestic product at market price		550
+ Net foreign primary income		(20)
National Income		**530**
(ii) Disposable Household Income		
Net National Income	530	
ADD: Government Transfer Payments	240	770
(-) Income not flowing to household		
Undistributed profits	40	
Company Tax	15	(55)
Household Income		715
(-) Personal Income Tax		(310)
Disposable Household Income		**405**

3. The following data of a hypothetical economy have been given [values in Rs. Billions)

Item	**Value**
Employment Income	225
Lease Rent	34
Interest	55
Undistributed profit	72
Mixed income (self-employment Income)	80
Net Exports	11
Fixed capital consumption (depreciation)	40
Other taxes on production-Subsidies	5
Corporate Income Tax	18
Net Indirect Taxes	20
Dividends	16
Net Foreign primary income	5

Calculate the Gross National Income at market prices using the above data.

Answer

	Rs. Billions
Employment Income	225
Net operating surplus (34+55+72+18+16)	195
Mixed income	80
Fixed Capital Consumption	40
Other Taxes on production – Subsidies	5
Gross Value Added	**545**
Add: Net indirect taxes	20
Gross Domestic Product at market prices	**565**
Add: Net foreign primary income	5
Gross National Income at market prices	**570**