

Chapter 6

Assessing the
Economy's
Performance

Two

Approaches to
GDP

Expenditure

Approach

GDP

Approaches

Compared

Income

Approach

Nominal vs.

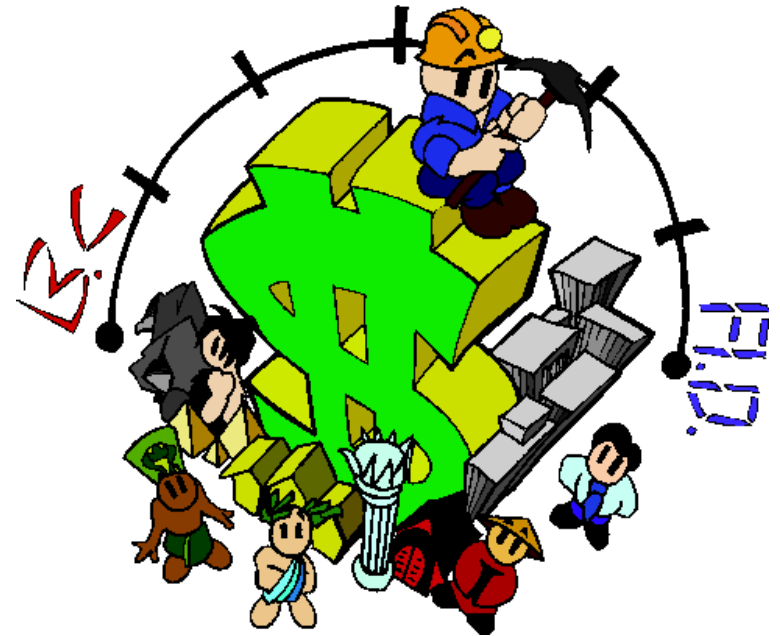
Real GDP

Shortcomings

of GDP

Last Word

6



Measuring Domestic Output and National Income

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Chapter Objectives

- **How GDP is Defined and Measured**
- **Relationships Between GDP, Net Domestic Product, National Income, Personal Income, and Disposable Income**
- **The Nature and Function of a GDP Price Index**
- **The Difference Between Nominal GDP and Real GDP**
- **Some Limitations of the GDP Measure**

Chapter 6

Assessing Economy's Performance

- National Income Accounting – measures the economy's overall performance
 - Bureau of Economic Analysis (BEA) – compares levels of production at regular intervals
 - Tracks long-run trends
 - Info used to formulate policies

Assessing the
Economy's
Performance

Two

Approaches to
GDP

Expenditure
Approach

GDP

Approaches
Compared

Income

Approach

Nominal vs.

Real GDP

Shortcomings
of GDP

Last Word

Key Terms



End Show



Chapter 6

Assessing Economy's Performance

- Gross Domestic Product (GDP) – the total market value of all final goods and services produced (in the U.S.A) in a given year
 - A monetary measure of total (aggregate) output
 - Avoid Multiple Counting (only FINAL goods)
 - Intermediate Goods – inputs purchased by producers for manufacturing (EX-parts for a car)
 - Final Goods – finished products purchased by the consumer (finished vehicle)
 - Value Added - \$ value of improvements a firm makes in the production process

Assessing the
Economy's
Performance

Two
Approaches to
GDP

Expenditure
Approach

GDP

Approaches
Compared

Income
Approach

Nominal vs.
Real GDP

Shortcomings
of GDP

Last Word

Key Terms



End Show



Chapter 6

Assessing Economy's Performance

• Non-Production Transactions Excluded from GDP

– Financial Transactions

- Public Transfer Payments – payments from the Gov to households (SS, welfare, etc.)
- Private Transfer Payments – money transferred between people (allowance, gift money, etc.)
- Stock (and Bond) Market Transactions – these are simply exchanges of money (certificates).

- Second Hand Sales – used goods do not count in GDP (they have already been counted in a previous year)

Assessing the Economy's Performance

Two

Approaches to

GDP

Expenditure

Approach

GDP

Approaches

Compared

Income

Approach

Nominal vs.

Real GDP

Shortcomings

of GDP

Last Word

Key Terms



End Show



Chapter 6

Assessing the
Economy's
Performance

Two
Approaches to
GDP

Expenditure
Approach
GDP

Approaches
Compared

Income
Approach
Nominal vs.

Real GDP
Shortcomings
of GDP

Last Word

Two Approaches to GDP

- Expenditure Approach - sum of all money spent on final goods and services in the year ($GDP = C + I + G + X_n$)
 - Final-Product (price of all final goods/services) or
 - Value-Added (additional value added in each step of production of goods/services)
- Income Approach – sum of all the income derived or created from producing all the goods/services in the year
 - Wages
 - Rental Incomes
 - Interest Incomes
 - Profits
 - **Statistical adjustments**

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP
Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Two Approaches to GDP

Expenditure Approach

Income Approach

Consumption by Households



Investment by Businesses



Government Purchases



Expenditures By Foreigners

G
= D =
P

Wages



Rents



Interest



Profits



Statistical Adjustments

Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Expenditure Approach

Personal Consumption Expenditures **C**

- Durable Consumer Goods (appliances, cars)
- Nondurable Consumer Goods (food, toiletries)
- Consumer Expenditures for Services (Dr., lawyers, barbers, lawn care)

Gross Private Domestic Investment **I_g**

- Machinery, Equipment, and Tools (businesses purchasing capital)
- All Construction
- Changes in Inventories (increase or decrease in unsold goods)
- Gross vs. Net Investment
 - Gross = all investment in new or replacement capital
 - Net = only investment in new capital (Gross-depreciation)

Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP
Expenditure Approach
GDP
Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Expenditure Approach

Government Purchases

G

- Expenditures for Goods and Services - what gov consumes in order to provide public services
 - EX - textbooks used in public schools, teacher salary
- Expenditures for Social Capital – gov spending on building roads, bridges, damns, etc.

Net Exports

X_n

- $X_n = \text{Exports } (X)$ goods produced here and sold abroad
- $\text{Imports } (M)$ goods produced abroad, purchased here

Putting It All Together:

$$GDP = C + I + G + X_n$$

$$GDP = \$8,746 + 2,105 + 2,363 - 727 = \$12,487 \text{ in 2005}$$

Chapter 6

Assessing the Economy's Performance

Two Approaches to GDP Expenditure Approach GDP Approaches Compared Income Approach Nominal vs. Real GDP Shortcomings of GDP Last Word

Key Terms

End Show

GDP Approaches Compared

Accounting Statement for the U.S. Economy, 2005
in Billions

<i>Receipts Expenditures Approach</i>		<i>Allocations Income Approach</i>	
Personal Consumption (C)	\$ 8746	Compensation	\$ 7125
Gross Private Domestic		Rents	73
Investment (I _g)	2105	Interest	498
Government Purchases (G)	2363	Proprietor's Income	939
Net Exports (X _n)	-727	Corporate Profits	1352
		Taxes on Production and Imports	<u>917</u>
		National Income	\$10,904
		Net Foreign Factor Income	-34
		Statistical Discrepancy	43
		Consumption of Fixed Capital	<u>1574</u>
Gross Domestic Product	\$ 12,487	Gross Domestic Product	\$ 12,487

Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show

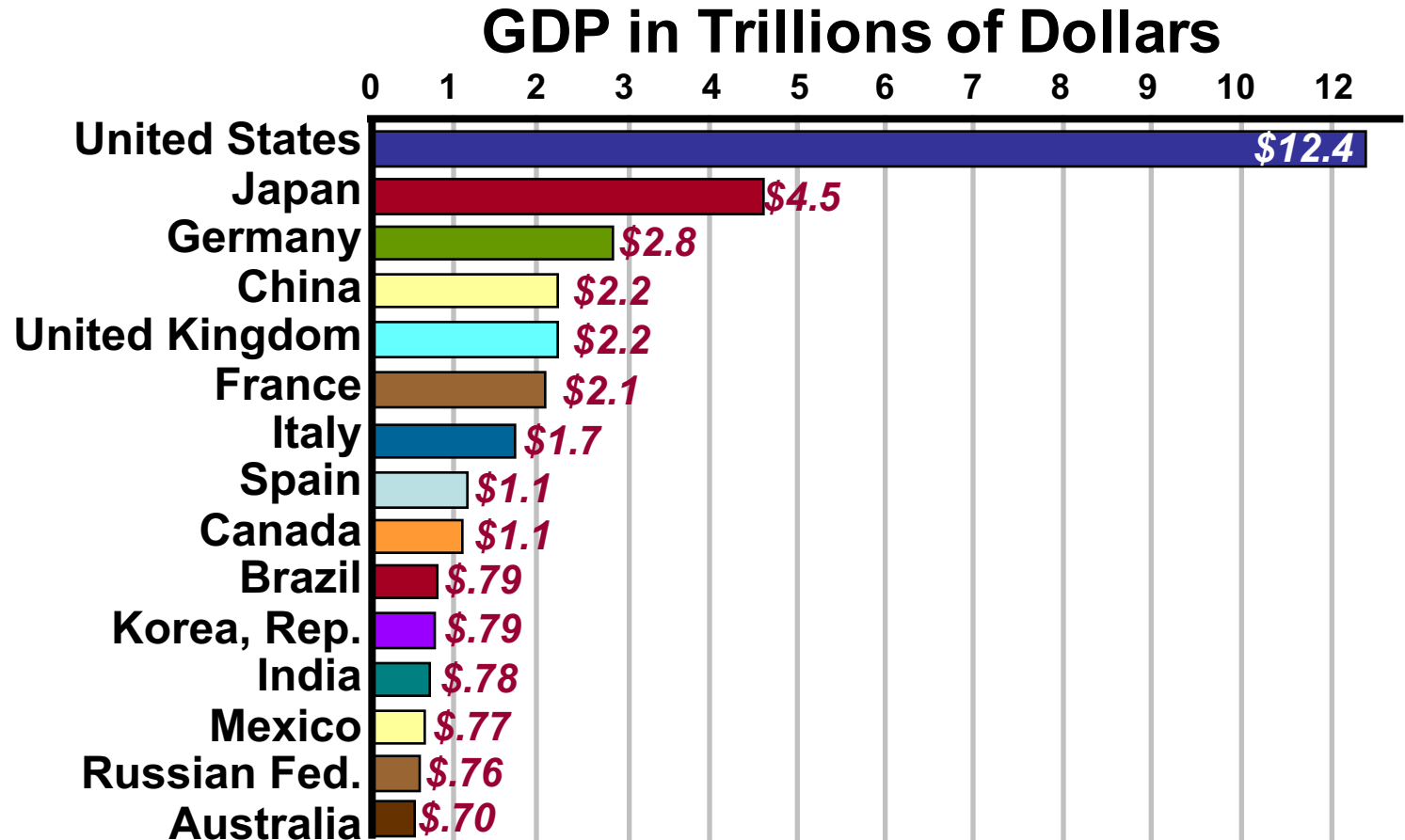


Comparative GDPs



GLOBAL PERSPECTIVE

Select Nations GDPs - 2005



Source: World Bank

Chapter 6

Assessing the
Economy's
Performance
Two
Approaches to
GDP
Expenditure
Approach
GDP
Approaches
Compared
Income
Approach
Nominal vs.
Real GDP
Shortcomings
of GDP
Last Word

Key Terms



End Show



The Income Approach

- Compensation of Employees- wages, salaries, and contributions into pension plans or social insurance programs
- Rents – private and business rental payments for housing or office space
- Interest- business interest payments, private interest income from savings
- Proprietor's Income- includes the net income of business owners

Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



The Income Approach

- Corporate Profits
 - Corporate Income Taxes (flows to gov)
 - Dividends (income to stockholders = households)
 - Undistributed Corporate Profits (retained earnings to be used for future investment)
- Taxes on Production and Imports-
included due to convenience (since 2003)
 - by adding taxes the price of a good will represent the private/business income as well as the gov tax revenue

Chapter 6

Assessing the
Economy's
Performance
Two
Approaches to
GDP
Expenditure
Approach
GDP
Approaches
Compared
Income
Approach
Nominal vs.
Real GDP
Shortcomings
of GDP
Last Word

The Income Approach

- From National Income to GDP
 - Net Foreign Factor Income – difference between the income Americans earn from supplying resources abroad vs. the income foreigners earn from supplying resources here
 - Statistical Discrepancy – added to make the income approach match the expenditures approach
 - Consumption of Fixed Capital – (depreciation) reduced value of capital/equipment in a given year



W 6.1

Key Terms



End Show



Chapter 6

Assessing the
Economy's
Performance

Two
Approaches to
GDP

Expenditure
Approach
GDP

Approaches
Compared
Income

Approach
Nominal vs.
Real GDP

Shortcomings
of GDP
Last Word

Other National Accounts

- Net Domestic Product (NDP) –
 - $NDP = GDP - \text{depreciation}$
- National Income (NI) – includes all income earned through the use of American-owned resources (here or abroad) and taxes on production and imports
 - $NI = NDP$
 - Statistical discrepancy
 - + net foreign factor income

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP
Expenditure Approach
GDP
Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Other National Accounts

- Personal Income (PI) – all income received (earned or unearned)
 - $PI = NI - \text{taxes}$
 - SS contribution
 - corporate income tax
 - undistributed corporate profits
 - + transfer payments
- Disposable Income (DI) – income leftover after paying all taxes

$$DI = C + S$$

Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



The Income Approach

Income Relationships – United States, 2005

Gross Domestic Product (GDP)	\$ 12,487
Consumption of Fixed Capital	-1,574
Net Domestic Profit (NDP)	\$ 10,913
Statistical Discrepancy	-43
Net Foreign Factor Income	34
National Income (NI)	\$ 10,904
Taxes on Production and Imports	-917
Social Security Contributions	-871
Corporate Income Taxes	-378
Undistributed Corporate Profits	-460
Transfer Payments	+1,970
Personal Income (PI)	\$ 10,248
Personal Taxes	-1,210
Disposable Income (DI)	\$ 9,038

Chapter 6

Assessing the
Economy's
Performance
Two
Approaches to
GDP
Expenditure
Approach
GDP
Approaches
Compared
Income
Approach
Nominal vs.
Real GDP
Shortcomings
of GDP
Last Word

Key Terms



End Show



Nominal Versus Real GDP

- **Nominal GDP** – (unadjusted GDP) based on current market prices
- **Real GDP** – (adjusted GDP) has been inflated or deflated to reflect inflation or deflation that has occurred relative to a base year
- **Price Index** – the price of a “market basket” of goods in a given year as compared to the same goods in a reference year.

$$\text{Price Index In Given Year} = \frac{\text{Price of Market Basket In Current Year}}{\text{Price of Same Basket In Base Year}} \times 100$$

$$\text{Real GDP} = \frac{\text{Nominal GDP}}{\text{Price Index (in hundredths)}}$$

Chapter 6

Assessing the
Economy's
Performance
Two
Approaches to
GDP
Expenditure
Approach
GDP
Approaches
Compared
Income
Approach
Nominal vs.
Real GDP
Shortcomings
of GDP
Last Word

Shortcomings of GDP

- Nonmarket Activities- Homemakers, DIY repairs
- Leisure – benefits from working less hours
- Improved Product Quality – hard to measure
- The Underground Economy – unreported income over \$1 trillion!
- GDP and the Environment – negative externalities
- Composition and Distribution of the Output – are we making constructive or destructive products and who has access to them?
- Noneconomic Sources of Well-Being – crime rate, race relations, abuse

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms

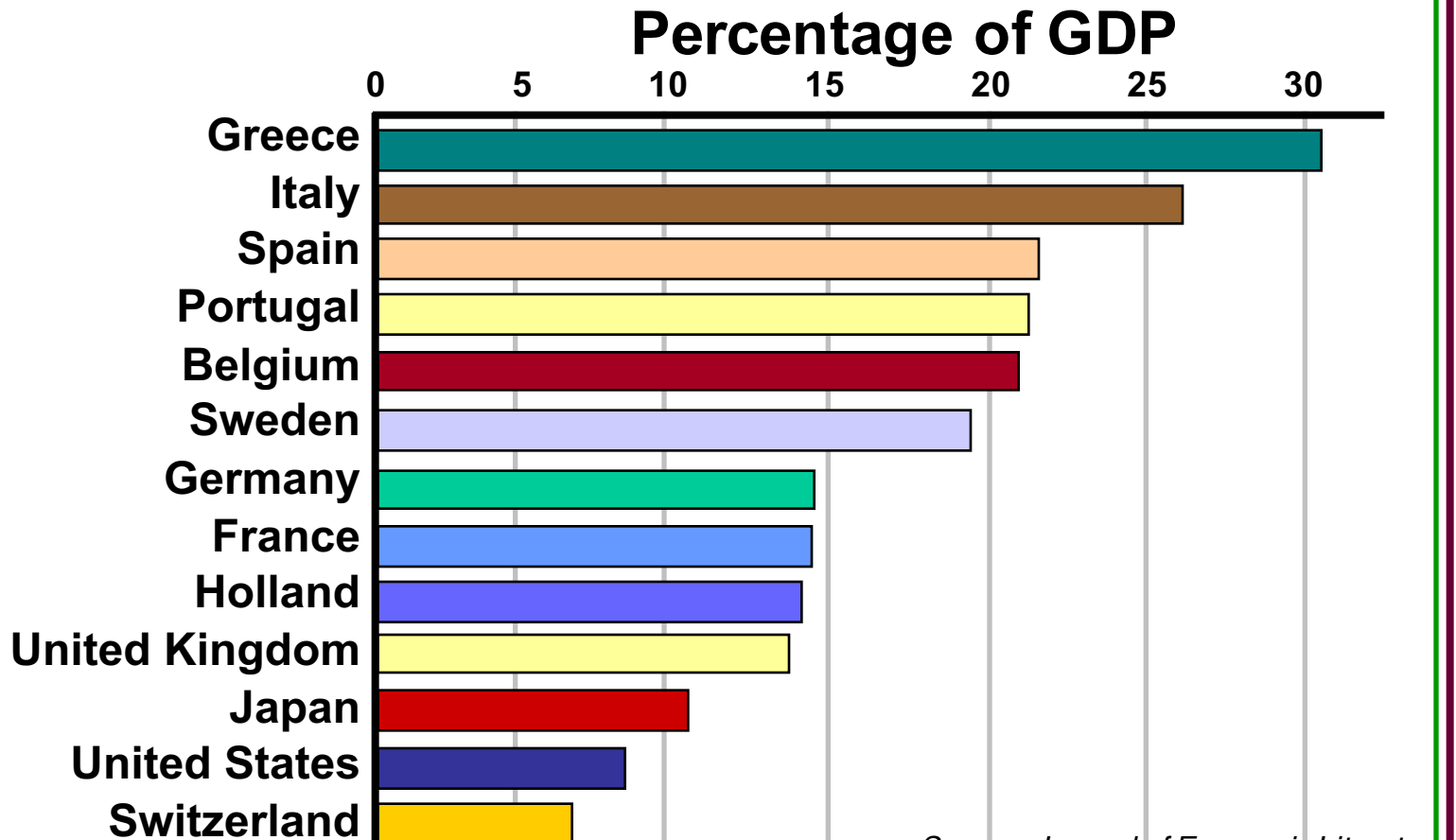
End Show

Shortcomings of GDP



GLOBAL PERSPECTIVE

Underground Economy as a Percentage of GDP - Select Nations



Source: Journal of Economic Literature

Magical Mystery Tour



BEA Sources of Data for Analysis

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Consumption

- Census Bureau's Retail Trade Survey
- Census Bureau's Survey of Manufacturers
- Census Bureau's Service Survey

- Investment

- All Consumption Data Sources
- Survey of Manufacturers
- Service Survey
- Industry Sources
- Census Bureau's Housing Starts Survey and Housing Sales Survey
- Retail Trade Survey
- Wholesale Trade Survey
- Survey of Manufacturing

Key Terms



End Show



Magical Mystery Tour

Last Word

Assessing the Economy's Performance
Two Approaches to GDP Expenditure Approach
GDP
Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

- **Government Purchases**
 - Office of Personnel Management
 - Construction Surveys
 - Census Bureau's Survey of Government Finance
- **Net Exports**
 - U.S. Customs Service
 - BEA Surveys and Analysis

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance

Two

Approaches to GDP

Expenditure

Approach

GDP

Approaches

Compared

Income

Approach

Nominal vs.

Real GDP

Shortcomings

of GDP

Last Word

Key Terms

- national income accounting
- gross domestic product
- intermediate goods
- final goods
- multiple counting
- value added
- expenditures approach
- income approach
- personal consumption expenditures (C)
- gross private domestic investment (I_g)
- net private domestic investment
- government purchases
- net exports (X_n)
- taxes on production and imports
- national income
- consumption of fixed capital
- net domestic product (NDP)
- personal income (PI)
- disposable income (DI)
- nominal GDP
- real GDP
- price index

Key Terms



End Show



Chapter 6

Assessing the Economy's Performance
Two Approaches to GDP
Expenditure Approach
GDP Approaches Compared
Income Approach
Nominal vs. Real GDP
Shortcomings of GDP
Last Word

Key Terms



End Show



Next Chapter Preview...



Introduction to Economic Growth, Unemployment, and Inflation

Coming Soon!!!