**Assignment 2 (10 points)**

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|  | Bread company | Cheese company | Pizza company |
| Cost of inputs | $0 | $0 | $50 (bread)  $35 (cheese) |
| Wages | $15 | $20 | $75 |
| Value of output | $50 | $35 | $200 |
| **Value added** | **$50** | **$35** | **$115** |
| **Profit** | **$35** | **$15** | **$40** |

1. GDP as the value added in production. $200

The value added of a producer is the value of its sales minus the value of its purchases of intermediate goods and services. According to this statement,

GDP (the value added in production) = ($50-$0) + ($35-$0)+($200-($50+$35))=$200

1. GDP as spending on final goods and services. $200

We solve this problem by counting only the value of sales to *final buyers,* such as consumers, firms that purchase investment goods, the government, or foreign buyers. In other words, in order to avoid double-counting of spending, we omit sales of inputs from one business to another when estimating GDP using spending data. Aggregate spending on final goods and services—the finished Pizza—is $200.

1. GDP as factor income.$200

GDP (factor income) =sum of wages + sum of rents + sum of interest payments + sum of profits =($15+$20+$75)+$0+$0+($35+$15+$40)=$200

Summary: in all situation the result of GDP should be equal.

1. Why is the growth of GDP important to businessmen and policymakers? What does growth of GDP indicate? What are the limitations of GDP as a measure of a country’s economic performance? Briefly explain (7 points).

Answer: Policymakers, government officials, businesses, economists and the public alike rely on GDP and related statistics to help assess the economy’s well-being and to make informed decisions. **Policymakers** will look to GDP when contemplating decisions on interest rates, tax and trade policies. **Economists**study GDP and related statistics to help inform their research. GDP reflects production in a given time period, regardless of whether that production is used for consumption, for investment in new fixed assets or inventories, or for replacing depreciated fixed assets. The GDP growth rate is the most important indicator of economic health. It changes during the four phases of the business cycle: peak, contraction, trough, and expansion. When the economy is expanding, the GDP growth rate is positive. There are some limitations as a measure of a country’s economic performance : The exclusion of non-market transactions; The failure to account for or represent the degree of income inequality in society; The failure to indicate whether the nation’s rate of growth is sustainable or not; The failure to account for the costs imposed on human health and the environment of negative externalities arising from the production or consumption of the nation’s output; Treating the replacement of depreciated capital the same as the creation of new capital.