

Ch. 21 Monitoring the Value of Production: GDP

Principles of Macroeconomics

ECON 102

Outline

- Gross Domestic Product
- Measuring GDP
- Uses and limitations of GDP

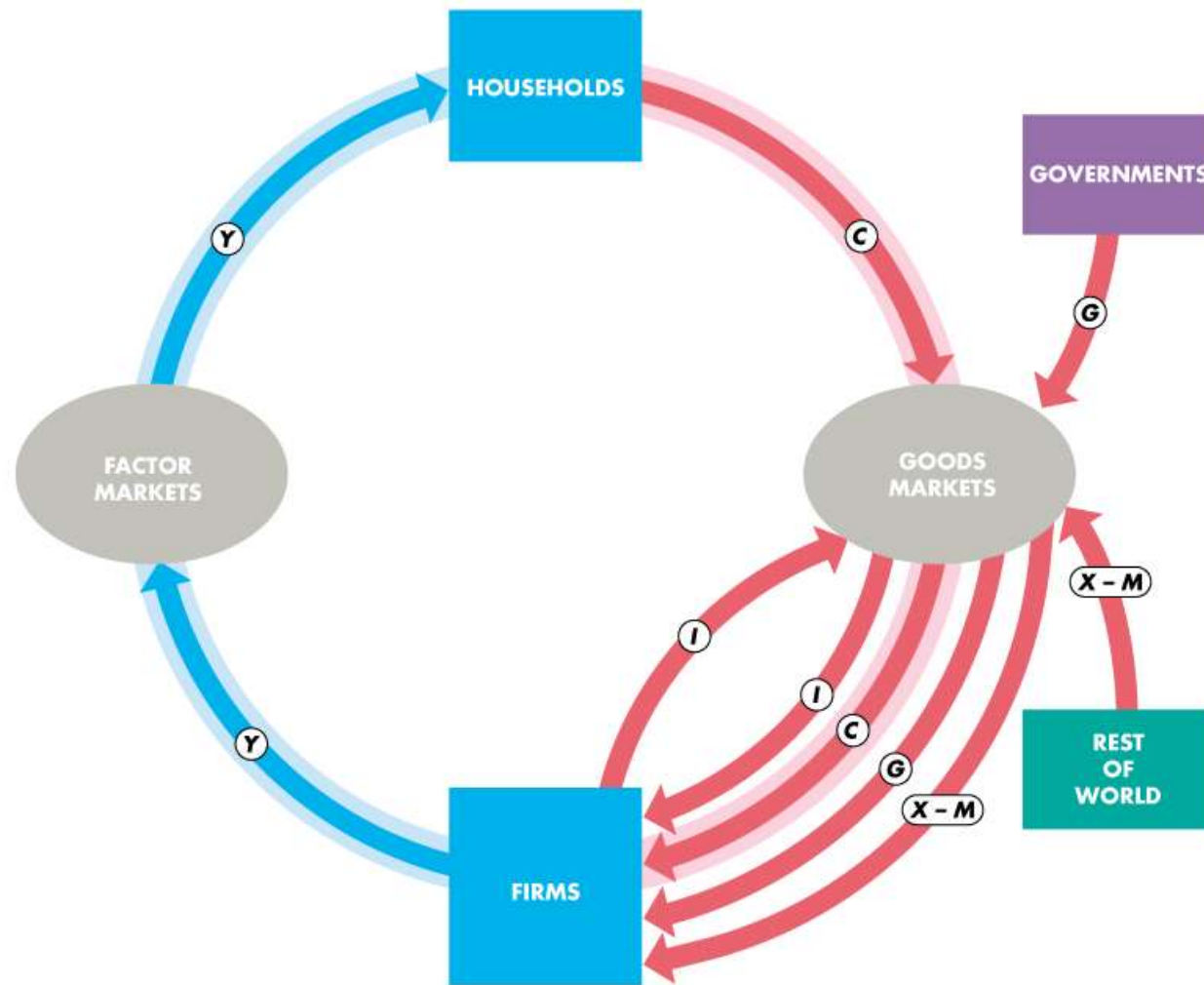
Gross Domestic Product

- Definition
 - The market value of the final goods and services produced within a country in a given time period
- 4 major components:
 - Market value
 - Final goods and services
 - Produced within a country
 - In a time period

Circular flow of expenditure and income (1)

- For every product that is produced within a country, there are:
 - Producers -> produce the product and sell it
 - Consumers -> buys the product and use it
- Money has to flow from consumers to producers and then back to consumers. It's a cycle!

Circular flow of expenditure and income (2)



GDP in equation

- $Y = C + I + G + X - M$
 - Y is income
 - C is consumption expenditure
 - I is investment
 - G is government expenditure
 - X is exports
 - M is imports
- Leakages vs injections
 - Leakage is when the money is going out of the cycle
 - Injection is when the money is going into the cycle

Measuring GDP

- The expenditure approach
 - Based on the money being used to purchase the domestic products
 - $C + I + G + X - M$
- The income approach
 - Based on the money received involving the sales of the domestic products
 - Compensation of employees, net interest, rental income, corporate profits, and proprietor's income
- What price do we use?
 - Base price vs market price

Market price issue

- If market price is used for GDP measurement, a change in price will change GDP!
 - If price goes up, then GDP will increase as well
 - But not necessarily mean that the economic activities are increasing, especially if the number of domestic products are the same or even less
- Nominal GDP vs Real GDP
 - Nominal GDP is when we use the market price as is
 - Real GDP is when we use the market price of a reference year

The uses and limitations of GDP (1)

- GDP is used for standard of living over time
 - Examining the progress/growth of a country
 - Fluctuations of GDP
 - Expansion vs recession
 - Peak vs trough
- GDP can be used to compare standard of living across countries
 - Not really fair due to different cost of living
 - Uses PPP (Purchasing Power Parity)

The uses and limitations of GDP (2)

- There are activities that are not included in GDP calculation:
 - Household production -> think of DIY activities. It produces something, yet not being counted
 - Underground economic activity -> illegal activities or unreported
 - Leisure time -> adds into the standard of living, but somehow not included in GDP
 - Environmental quality -> GDP disregards the impact of economic activities to the environment