

CHAPTER 25

Assessing the Economy's Performance

National Income Accounting - measures the economy's overall performance

Gross Domestic Product

Gross Domestic Product - defines aggregate output as the dollar value of all final goods and services produced within the borders of a given country during a given period of time, typically a year.

Avoid Multiple Counting - intermediate goods vs final goods

Intermediate Goods - are goods and services that are purchased for resale or for further processing or manufacturing

Final Goods - are consumption goods, capital goods, and services that are purchased by their final users, rather than for resale or for further processing or manufacturing

Assessing the Economy's Performance

- GDP excludes nonproduction transactions
 - Financial transactions
 - Public transfer payments
 - Private transfer payments
 - Stock market transactions
 - Secondhand sales
- Two ways of looking at GDP
 - **Expenditures approach** - the sum of all money spent on buying the GDP
 - **Income approach** - income derived / created from producing the GDP

The Expenditures Approach

- **Personal Consumption Expenditures (C)** - consumption expenditure by households
- **Gross Private Domestic Investment (I_g)** - all final purchases of machinery, equipment, and tools by business enterprises, all construction, changes in inventories
 - Gross Investment vs Net Investment
Net Investment (I_n) = Gross Investment (I_g) - depreciation
- **Government Purchases (G)** - expenditures for goods and services that government consumes in providing public services, and expenditures for publicly owned capital such as schools and highways, which have long lifetimes. Government purchases (federal, state, and local) include all government expenditures on final goods and all direct purchases of resources including labor.
- **Net Exports (X_n)** - exports (X) - imports (M) $\implies X_n = X - M$
- **GDP = C + I_g + G + X - M** or **GDP = C + I_g + G + X_n**

Nominal GDP vs Real GDP

- **Nominal GDP = Actual GDP**
- **Real GDP = Nominal GDP adjusted for inflation (or deflation)**
- **Price Index** - is a measure of the price of a market basket in a given year compared to the price of an identical collection of goods and services in the reference year.
- **Price index** in a given year = $\frac{\text{price of market basket in specific year}}{\text{price of same market basket in base year}} * 100$
- Price index_{year 2} = $(\$20 / \$10) * 100 = 200$
Price index_{year 3} = $(\$25 / \$10) * 100 = 250$
- **Real GDP** = $\frac{\text{nominal GDP}}{\text{price index (in hundredths)}}$ \Rightarrow Real GDP_{year 2} = $\$140 / 2 = \70
- **Price index** (in hundredths) = nominal GDP / real GDP
- Shortcomings of GDP - Nonmarket activities, improved product quality, the underground economy

National Accounts and the Income Approach

- **Net Domestic Product (NDP)** \Rightarrow $NDP = GDP - \text{depreciation}$
- **National Income (NI)** - includes all income earned through the use of American-owned resources, whether they are located at home or abroad
- **Personal Income (PI)** - includes all income received, whether earned or unearned
- **Disposable Income (DI)** - personal income (PI) less personal taxes ($DI = C + S$)
- **Compensation of employees** - wages, salaries, supplements, pension, health benefits
- **Rents** - payments tenants make to landlords
- **Interest** - money paid by business for loans and interest households receive on deposits
- **Proprietors' Income** - profits - unincorporated and incorporated businesses
- **Corporate profits**
 - Corporate income taxes - dividends, undistributed corporate profits, taxes on production and imports

National Accounts and the Income Approach

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| | Billions |
|---|-----------------|
| Gross domestic product | \$16,245 |
| <i>Less:</i> Consumption of fixed capital | 2,543 |
| <i>Equals:</i> Net domestic product | \$13,702 |

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| | Billions |
|--|-----------------|
| National income | \$13,972 |
| <i>Less:</i> Taxes on production and imports | 1,066 |
| <i>Less:</i> Social Security contributions | 951 |
| <i>Less:</i> Corporate income taxes | 435 |
| <i>Less:</i> Undistributed corporate profits | 542 |
| <i>Plus:</i> Transfer payments | 2,766* |
| <i>Equals:</i> Personal income | \$13,744 |

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| | Billions |
|--|-----------------|
| Net domestic product | \$13,702 |
| <i>Less:</i> Statistical discrepancy | -17 |
| <i>Plus:</i> Net foreign factor income | 253 |
| <i>Equals:</i> National income | \$13,972 |

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| | Billions |
|----------------------------------|-----------------|
| Personal income | \$13,744 |
| <i>Less:</i> Personal taxes | 1,498 |
| <i>Equals:</i> Disposable income | \$12,246 |