CHAPTER II

Assessing the Economy's Performance

National Income Accounting - measures the economy's overall performance

Gross Domestic Product

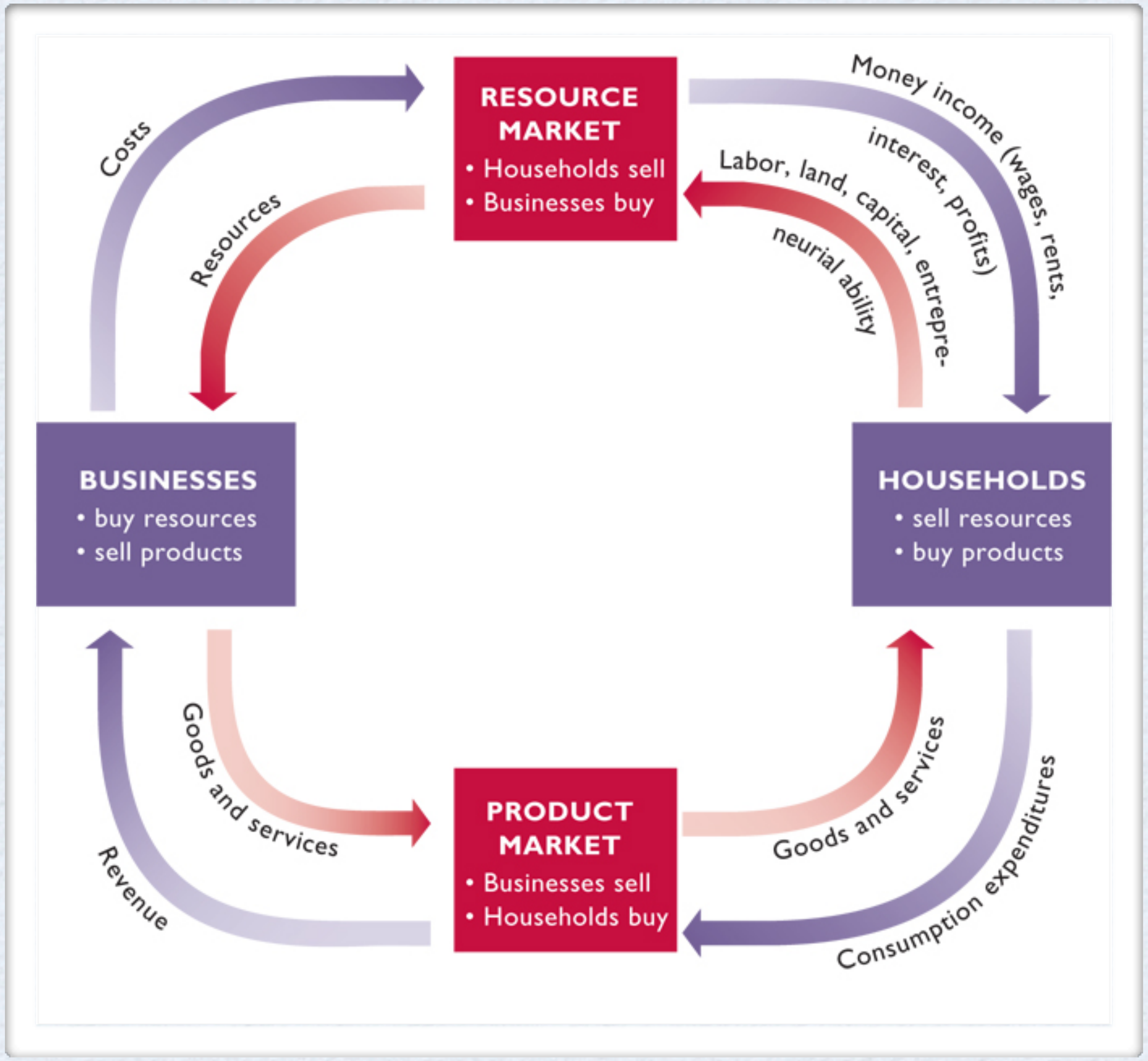
Gross Domestic Product - defines aggregate output as the dollar value of all final goods and services produced within the borders of a given country during a given period of time, typically a year.

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

The Circular Flow Model



- 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) ➠ $X_n = X - M$
- **$GDP = C + I_g + G + X - M$** or **$GDP = C + I_g + G + X_n$**

Other National Accounts

- **National Income (NI)** - includes all income earned through the use of American-owned resources, whether they are located at home or abroad
  NI = GDP - depriciation
- **Personal Income (PI)** - includes all income received
- **Disposable Income (DI)** - personal income (PI) less personal taxes (DI = C + S)

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** = $\dfrac{\text{price of market basket in specific year}}{\text{price of same market basket in base year}} * 100$
- Price index $_{\text{year 2}}$ = (\$20/\$10) * 100 = 200
  Price index $_{\text{year 3}}$ = (\$25/\$10) * 100 = 250
- **Real GDP** = $\dfrac{\text{nominal GDP}}{\text{price index (in hundredths)}} * 100$ ➠ Real GDP $_{\text{year 2}}$ = \$140 / 2 = \$70
- **Price index** (in hundredths) = nominal GDP / real GDP
- Shortcomings of GDP - Nonmarket activities, improved product quality, the underground economy