

Outline for lecture 8

ECON 1a, Fall 2007, Warren Gibson

“Measuring” a nation’s income. Text chapter 10

- Microeconomics and macroeconomics
 - Microeconomics is the study of choices made by individuals and households
 - Macroeconomics is the study of the economy as a whole:
 - * Inflation
 - * Unemployment
 - * Business cycles (“boom and bust”)
 - * Economic growth
 - * Money and banking
- Gross domestic product (GDP)
 - Words:
 - * “Gross” as opposed to “net”
 - * “Domestic:” within the U.S.
 - * “Product:” produced goods and services
 - Why do we care about GDP?
 - * Supposed to be a proxy for general welfare
 - * Provides jobs for lots of bureaucrats and financial commentators.
 - Definition: “Market value of all final goods and services produced within a country in a given period of time.”

- * Market value: prices observed in exchanges
- * All: tries to include all legally produced goods and services that are sold. Excludes
 - “Black market” transactions
 - Barter transactions
 - Production for one’s own use.
- * Within a country (sometimes a state)
- * A given period of time: almost always one year
- It is very difficult to define what categories should and shouldn’t be included in national income and how much income actually occurs in each category.
- Housing: homeowners are assumed to rent their houses from themselves. Attempt to deal with a problem:
 - * House prices are very important to someone looking to buy a house
 - * House prices don’t mean as much to someone who already owns a house.
 - * Why not assume car owners lease their cars to themselves?
- Only final goods and services are counted. Otherwise if something were sold repeatedly it would be misleading to count each sale price.
 - * Buying an economics text and paying to hear an economics lecture both would contribute to GDP.
 - * Buying a used textbook doesn’t add to GDP. But the service provided by the clerk who handles the purchase of the used textbook *does* count.

- * If I pay you \$500 to fix my car and you pay me \$500 to lecture on economics, GDP goes up by \$1,000.
 - * If we trade car repair for lectures, there is no increase in GDP
 - * If I fix my own car and you study economics from a book, there is no increase.
- GDP is assumed to be a proxy for general welfare. Two ways to use GDP
- * Compare the GDP of a selected country at different times. For this sort of study we want the annual growth rate of GDP in percent. GDP growth is reported for quarters and is annualized.
 - * Compare the GDP's of various countries at a particular time. This requires an extra step of translating prices into a single currency.
- Components of GDP (Y)

$$Y = C + I + G + NX$$

- * C = consumption
 - Goods that we buy to use (durable, like cars and appliances) and non-durable (like food and clothing). Housing is excluded.
 - Services like haircuts and medical care.
- * I = Investment: goods to be used to produce more goods:
 - Capital equipment
 - Inventories
 - Structures

- * G = Government purchases:
 - Salaries of officials and politicians
 - Goods and services procured from suppliers
 - Not transfer payments
- * NX = Net exports = exports - imports, could be negative (and has been for many years in the U.S.)
- * Table p. 211
- Problem with including government purchases: financed by coercion therefore dubious as a contribution to general welfare. From the viewpoint of an individual taxpayer, some government purchases could be
 - * Good: things a person would have chosen to pay for without coercion
 - * Neutral: things a person is indifferent to; waste
 - * Bad: things a person considers harmful and would have paid to avoid
- Problem with computing changes in GDP over time: inflation. Solution: choose a year (the “base year”) and use only prices from that year. The result is the “real” or “inflation-adjusted” GDP.
- Example p. 212
- GDP deflator definition = nominal/real. This number takes out or “deflates” inflationary effects that are present in nominal GDP.
- Other “measures” of national income

- Gross national product (GNP) counts all production by American firms, even if done overseas, but not production by foreign firms in the U.S.
- Net national product (NNP) subtracts depreciation from GNP.
- Personal income excludes retained earnings.
- Disposable personal income = income left after taxes.