National Income Accounting

Part 1

Laugher Curve

Three econometricians went out hunting, and came across a large deer.

The first econometrician fired, but missed, by a yard to the left.

Laugher Curve

The second econometrician fired, but also missed, by a yard to the right.

The third econometrician didn't fire, but shouted in triumph, "We got it! We got it!"

National Income Accounting

- ***National income accounting*** – a set of rules and definitions for measuring economic activity in the aggregate economy – that is, in the economy as a whole.
- National income accounting is a way of measuring total, or aggregate production.

Measuring Total Economic Output of Goods and Services

- ***Gross Domestic Product*** (***GDP***) is the total value of all final goods and services produced in an economy in a one-year period.
- It is the single most-used economic measure.

Measuring Total Economic Output of Goods and Services

- ***Gross National Product*** (***GNP***) is the aggregate final output of citizens and businesses of an economy in one year.

Measuring Total Economic Output of Goods and Services

- GDP is output produced within a country's borders.
- GNP is output produced by a country's citizens.

Measuring Total Economic Output of Goods and Services

- Net foreign factor income is added to GDP to move from GDP to GNP.
  - ***Net foreign factor income*** is the income from foreign domestic factor sources minus foreign factor incomes earned domestically.

Calculating GDP

- Calculating GDP requires adding together million of goods and services.
- All goods and services produced by an economy must be weighted.
- Each good and service is multiplied by its price.

Calculating GDP

- Once quantities of a particular good or service are multiplied by its price, we arrive at a value measure of the good or service.
- All the units of value are added to arrive at GDP.

GDP Is a Flow Concept

- GDP is a flow concept.
- It is reported quarterly on an annualized basis.
  - ***Annualized basis*** – quarterly figures are used to estimate total output for the whole year.

GDP Is a Flow Concept

- The store of wealth is a stock concept.
- ***Wealth accounts*** – a balance sheet of an economy's stocks of assets and liabilities.

GDP Measures Final Output

- GDP does not measure total transactions in the economy.
- It counts final output but not intermediate goods.

GDP Measures Final Output

- ***Final output*** – goods and services purchased for final use.
- ***Intermediate products*** are used as input in the production of some other product.

GDP Measures Final Output

- Counting the sale of final goods and intermediate products would result in double and triple counting.

Two Ways of Eliminating Intermediate Goods

- There are two ways of eliminating intermediate goods.
- The first is to calculate only final output.
- A second way is to follow the value added approach.

Two Ways of Eliminating Intermediate Goods

- ***Value added*** is the increase in value that a firm contributes to a product or service.
- It is calculated by subtracting intermediate goods from the value of its sales.

Value Added Approach Eliminates Double Counting

Participants	Cost of Materials	Value of Sales	Value Added
Farmer	$ 0	$ 100	$ 100
Cone factory and ice cream-maker	100	250	150
Middleperson	250	400	150
Vendor	400	500	100
Totals	$ 750	$1,250	$500

Calculating GDP: Some Examples

- Selling your two-year-old car to a neighbor does not add to GDP.
- Selling your car to a used car dealer who then sells your car to someone else for a higher price, adds to GDP.
- The value of the dealer's services is added to GDP.

Calculating GDP: Some Examples

- Selling a stock or bond does not add to GDP.
- The stock broker's commission from the sales does add to GDP.

Calculating GDP: Some Examples

- Social security payments, welfare payments, and veterans' benefits, are not included in GDP.
- Only the cost of transferring is included in GDP.

Calculating GDP: Some Examples

- The work of unpaid housespouses does not appear in GDP calculations.
- GDP only measures market activities so unpaid value added is not included in GDP.