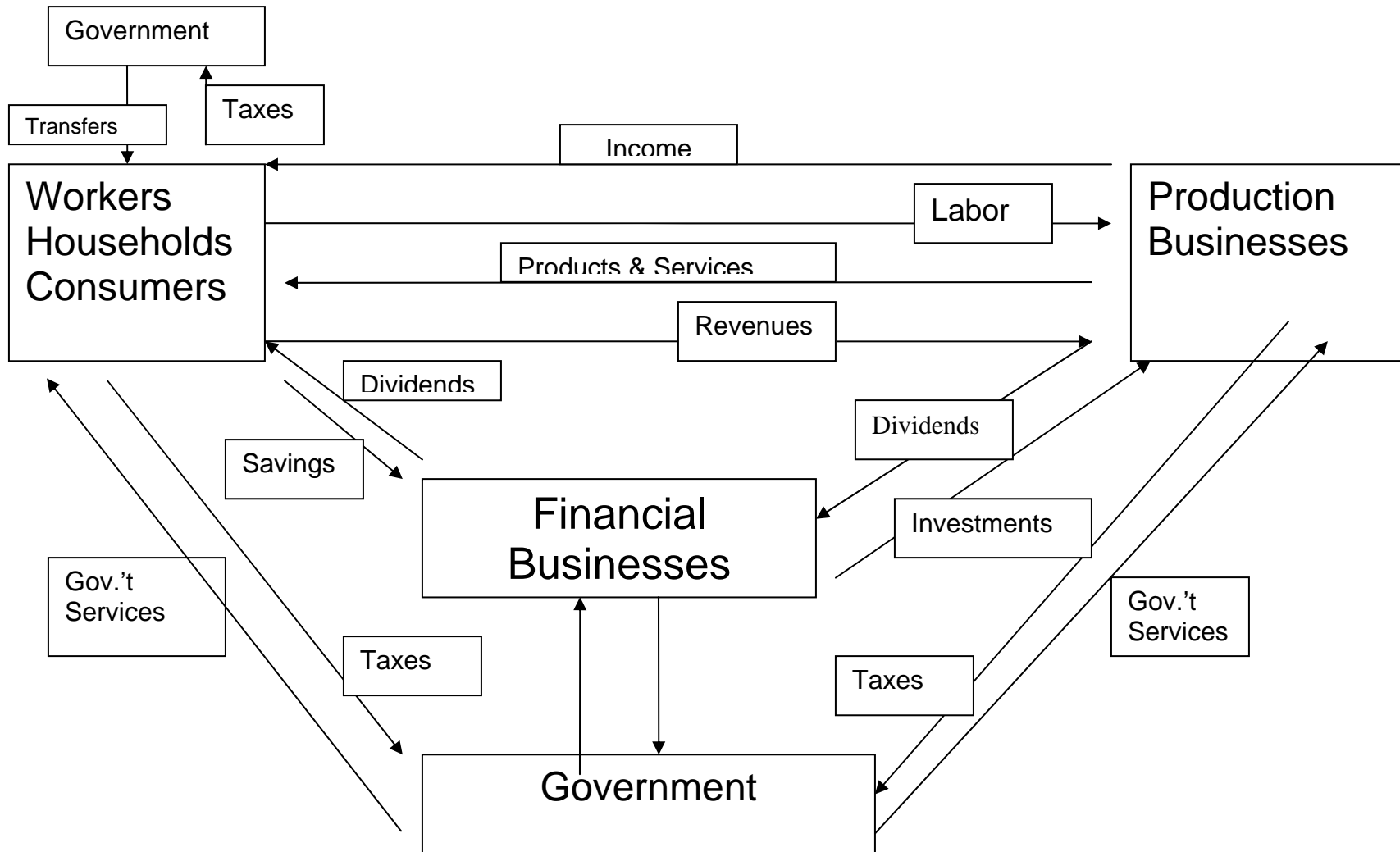


Lecture 15: Gross Domestic Product

I. Circular Flow of the Economy



Households provide workers to production businesses and receive income in return.

Households purchase products and services from production businesses, which provides production businesses with revenues.

Households provide savings to financial businesses, which invest in production businesses.

Production businesses pay dividends to financial businesses, which after a "cut", pass them back to households.

Households and businesses pay taxes to government, and government provides services to households and businesses. Services include public safety, national defense, roads, court system, and education.

Households also pay taxes to government, which then redistributes the money other households via government transfers.

II. Gross Domestic Product

1. Want a measure of the entire economy – no small task because our economy is so diverse.
2. Concept is *real gross domestic product*: total value of all “final” goods (products) and services produced during a particular year or period, adjusted to eliminate the effects of price changes.

Components:

Real: means adjusted for price changes (inflation)

Final: so don't double and triple count the value of inputs (example: don't want to count the value of a house and then separately count the value of the lumber at the lumber mill that was used to construct the house – so only count the value of the “final” product, the house)

Goods and services: include everything

U.S. real gross domestic product in 2005: almost \$12 trillion

3. Real gross *domestic* product vs. real gross *national* product

Real gross domestic product – value of production of goods and services in the U.S., including production from both U.S. companies and foreign companies operating in the U.S.

Real gross national product – value of production of goods and services of all U.S. companies operating in both the U.S. and in foreign countries

Both measures give very similar dollar values

4. Problems with real gross domestic product

- a) hard to measure value of service sector
- b) products or services only count if money changes hands
example: oil changes by a mechanic counts, but if vehicle owner does own oil change, value of labor doesn't count; also, housework by stay-at-home parents doesn't count, but hired cleaning and cooking services does count
- c) bartering is not counted
- d) leisure (value of doing nothing) is not counted
- e) any damage done in production (like pollution) is not subtracted

5. Real gross domestic product and the business cycle

Is the measure of the economy used to track its growth

So, real gross domestic product rises when economy is expanding, and real gross domestic product declines when economy is in recession.

What is usually tracked is the *growth rate* in real gross domestic product. So if growth rate is positive, economy is expanding, and if growth rate is negative, economy is in recession.

However, standard for a recession is that growth rate in real gross domestic product must be negative for a *minimum of six months*.

Since WW. II, there have been 11 combined expansions and recessions, with the average expansion lasting 4 years and the average recession lasting one year.

6. Last, what is an economic "*depression*"? - simply a very severe recession when economic production falls by more than 10%

III. Employment

1. To most people, the most important part of the economy - it is directly related to GDP.

2. Measurement

A. *labor force*: people who are working for pay plus people who don't have jobs and are unemployed

B. *employed*: people working for pay

C. *unemployed*: people not working for pay and who are looking for work

D. *unemployment rate*: the number of unemployed people as a percentage of the labor force

E. what unemployment doesn't measure

- people not working for pay who don't want to work for pay, people in the military, and people not in institutions

- the problem of *discouraged workers* – people who are not working for pay and want to work for pay, but have become so discouraged that they have stopped looking for work – they are NOT counted as unemployed

E. Another issue complicating the measurement of employment.

There are two job surveys:

Household survey: goes to people's residences and asks if they are working

Payroll survey: goes to existing businesses and counts employment

The two surveys can give different results: Household survey will pick up self employed workers and workers in just created businesses, whereas payroll survey won't. But payroll survey is based on a bigger statistical sample, so is considered more reliable.

(note: since 2001, household survey shows jobs have been created, but payroll survey shows jobs have been destroyed)

F. Types of unemployment

Frictional unemployment: unemployment related to people who are willingly in between jobs; not worrisome

Cyclical unemployment: unemployment related to the business cycle; cyclical unemployment drops during an economic expansion, and cyclical unemployment rises during an economic recession

Structural unemployment: unemployment related to the “destructive” part of “creative destructionism” – as the economy changes and some new industries are created while others are destroyed, there will be unemployment created as uncompetitive industries are destroyed.

Question: why don't the workers released from the destroyed industries just take jobs in the new industries? Because they won't necessarily have the skills and training for the new jobs.

Good example: the structural change currently occurring in North Carolina, with job losses in traditional industries (textiles, apparel, furniture, tobacco) and job gains in new industries like health, finance, and technology. Problem is the unemployed mill and factory worker can't just step in to the new jobs without substantial new education.