INTRODUCTION TO THE GLOBAL ECONOMY

Macroeconomics – the branch of economics that examines the workings and problems of the economy as a whole

Macroeconomic Aggregates

- **GDP** – total output of G&S produced in a country over given period of time; measure of national income or health of the economy; is a measure of national income
- **General Price Level** – average price of all the G&S in an economy

Ceteris Paribus – all other things being unchanged or held constant

Positive Economics – is about what is observed as facts, open to testings, can be proved or disproved; precision

Normative Economics – is about values, emotions, beliefs, involves value judgements; opinion; what you read in the news

Production Possibility Frontier – a curve showing the maximum attainable combinations of two products that may be produced with available resources

Opportunity Cost – the highest value alternative that must be given up to engage in an activity (what it means to give up something to get something)

Absolute Advantage – the ability of an individual, firm or country to produce more of a G&S than competitors using the same amount of resources

Comparative Advantage – the ability of an individual firm or country to produce a G&S at a lower opportunity cost than other producers

Increasing marginal opportunity demonstrates that the more resources already devoted to an activity, the smaller the payoff to devoting additional resources to that activity.

Economic Growth – the expansion of society's production potential; technological change can occur in one or both industries

Inferior Good – a G&S for which the demand increases as income falls and decreases as income rises

Normal Good – a G&S for which the demand increases as income rises and decreases as income falls

MEASURING THE ECONOMY

Circular Flow Diagram – illustrates the flow of spending and money in the economy. Firms sell G&S to households/firms/government. To produce G&S firms use labour, capital, natural resources, entrepreneurs. Households supply factors of production to firms in exchange for income (wages, interest, profit, rent). Firms make payment to households in exchange for hiring workers. Households also use their income to pay tax and save. Govt borrow this money from household. We can measure GDP either by calculating the total value of expenditure on final G&S or by calculating the total value of total income.

Final Good/Service is sold to end-users and a **total value** is the price of G&S.

Intermediate Good- a good that undergoes further processing before sold (tyres on brand new car)

Measuring GDP

1. **Production Approach**
   - Adds up the production of each firm or industry in the economy
   - Only count the **value added** in production

2. **Spending Approach**
   - Four categories of spending – consumption, investment, government expenditure and net exports
   - Y = C + I + G + NX
   - To increase GDP the government can spend more
   - **Transfer Payments** are NOT included in GDP as they don't relate to the purchase of current output (eg youth allowance)
   - **Trade Balance** is the value of exports minus imports, another name for net exports (NX); if exports are positive there is a trade surplus, if net exports are negative there is a trade deficit

3. **Income Approach**
   - The sum of labour income, capital income and indirect taxes less subsidies gives a measure of GDP – *very similar to the spending approach*

Real GDP – a measure of the volume of final G&S holding prices constant
Nominal GDP – the market value of final G&S evaluated at current year prices

- Real GDP increases much less than nominal GDP because real GDP is adjusted for rising prices
- Most of the increase in nominal GDP is due to rising prices

GDP Deflator – allows us to calculate changes in price level over time

Consumer Price Index (CPI) – a price index equal to the current price of a fixed market basket of consumer G&S in a base year (alternative inflation measure)

Economic Growth Rate – the rate of change in real GDP from one year to the next

Shortcomings of the GDP Measure
Real GDP per capita has shortcomings as an indicator of wellbeing in a society. Items are omitted such as
- Work and production in the home
- The underground economy, black market
- Distribution of GDP
- Value of Leisure
- Level, quality and access of healthcare and education
- Pollution or negative effects of production