THE NATIONAL ACCOUNTS

GDP

= The market value of a period's output in monetary terms

- Measured in terms of 'price' – indicator of society's evaluation of their relative worth

Final goods and services = purchased for final use and are not subject to further processing, manufacturing or resale

- Only final goods and services are counted in GDP
- To count intermediate consumption separately would involved double counting and provide an exaggerated estimate of GDP

GDP excludes non-productive transactions → transaction where no production of goods or services occurs

Purely financial transactions

- Public transfer payments: social security payments government makes to particular households (i.e. pension, sickness benefits)
- Private transfer payments: transfer of funds from one individual to another
- Buying or selling of shares/securities: simply the swapping of paper assets – they do not involve current production

Second hand sales

- Excluded because there is no current production and avoids double counting –would have been included in a previous GDP calculation

Expenditure Approach to GDP

= sum of all expenditure involved in taking that total output off the market

C + I + G + NX = GDP

Personal consumption expenditure (C)

- Expenditure by households on *durable consumer goods* (cars, refrigerators), *non-durable goods* (bread, milk, beer) and *services* (lawyers, doctors, builders).

Gross Private Investment (I)

- All investment spending by Australian business firms
- Private gross fixed capital expenditure plus increases in stocks from our national accounts
- What is included in investment spending?
  - Final purchases of machinery, equipment and tools by business enterprises
  - All building and construction (commercial and residential)
  - Cultivated biological resources (livestock and orchard growth)
  - Intellectual property products (computer software, mineral and petroleum exploration etc)
  - Ownership transfer costs (stamp duty, real estate agent fees and sales commission
  - Changes in stocks (inventories)
    - GDP must include the market value of any additions to stocks that accrue during the year (i.e. needs to be added to GDP)
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Distinction between *Gross* and *Net* Investment

Gross investment = production of all investment goods

- Those that are to replace the machinery, equipment and buildings used up in the current year's production (depreciation) i.e. replacement

- Any net additions to the economy's stock of capital i.e. added investment

Net private investment = added investment of non-government enterprises

- Net investment is a positive figure in an expanding economy
- Static economy is where gross investment and depreciation are equal
- Declining economy is when gross investment is less than depreciation

Government purchases of goods and services (G)

All government spending on the finished products of businesses, and all direct purchases of resources (e.g. labour) by government
NB: this excludes all government transfer payment

Net exports (X)

Add the value of exports of goods and services in determining GDP

Income Approach to GDP

= sum of all incomes derive from the production of GDP

Compensation of employees

- Wages and salaries that are paid to suppliers of labour – accounts for the fact that they are difficult to distinguish
- Wage and salary supplements too i.e. super payments, direct pensions and compensation payments

Gross operating surpluses

- Includes major payments of the profit, rent and interest types as well as depreciation
- Taxes less subsidies
  - Taxes: treated as costs of production by businesses and added to the prices of goods and services
    - Indirect business taxes to the government are not earned as income
  - Subsidies: payments to business to encourage production of a particular commodity or negative indirect taxes

Production approach

- Avoids double-counting by counting only the value added by each manufactures

Nominal v Real GDP
Money GDP (nominal): measured in current prices
Real GDP: adjusted for inflation by an implicit price deflator - also called constant price GDP)

Indicators of price adjustment
Consumer price index: measures the price level of a 'market basket' of goods and services for a typical family
Implicit priced deflator (GDP deflator): measure the average level of price changes of C, I, G and NX

Formula used for deflating:

$$\text{Real GDP} = \frac{\text{Money (Nominal) GDP}}{\text{Price index (as a decimal)}}$$

GDP and Social Welfare

There are certain non-market transactions that do appear in the calculation of production when determining GDP. For example the work of the homemaker, the work of the carpenter who repairs his/her own home, or the work of the professor who writes an unpaid scholarly article. They aren't included in the profit and loss statements of businesses or firms and, therefore, are overlooked by the national income accountants – causing GDP to be understated.

Leisure time

- Increased leisure time has added enormously to our well-being in a way that cannot be measured. Thus our system of public accounting understates our wellbeing – it does not recognise leisure-time.
- Nor does it take into account the satisfaction we may derive from work

Improved Product Quality

- GDP is a quantitative rather than a qualitative measure
- Does not accurately reflect improvements in the quality of products
- Improvement I the quality of produces does affect material wellbeing

Composition and distribution of output

- Changes in the composition and the allocation of total output among specific households may influence economic welfare
- GDP only reflects the size of the output however, and does not tell us if it 'right' for society
- Some economists feel that a more equal distribution of total output would increase national economic wellbeing
- GDP measures the total size of output but does not reflect changes in the composition and distribution of output that might also affect the economic wellbeing of society

Per capita output

- Often- the most meaningful measure of economic wellbeing is the per capita output.
- GDP measures the size of the total output – it may conceal or misrepresent changes in the standard of living of individual households in the economy
- E.g. GDP may rise significantly, but if the population is also growing rapidly, per capital standard of living may be relatively constant or may even be declining

GDP and the environment

- Undesirable by-products can accompany production and growth in GDP
- Dirty air and water, car junk-yards, congestion, noise and various types of environmental pollution
- These costs are currently not deducted from GDP – therefore GDP overstates our national economic welfare

Underground Economy

- This is the engagement of secret and illegal activities such as gambling, prostitution and selling narcotics
- These incomes for obvious reasons aren't declared
- But most people in the underground economy are in legal activities – but do not fully report their incomes.
    - i.e. a waiter keeping tips, cash-only jobs

- inflation and increased tax rates have also reduced real incomes – and thus encourages people to hide their income

Balance of payments account

- attempts to record all the transactions that take place between its residents and the residents of all foreign nations
- merchandise exports and imports, tourist expenditures, purchases and sales of shipping and insurance services; interest and divides received or paid abroad, purchase and sales of financial or real assets abroad

Current account balance: Australia’s trade in currently produced goods and services