

Big Question: How do we measure the performance of an economy ?

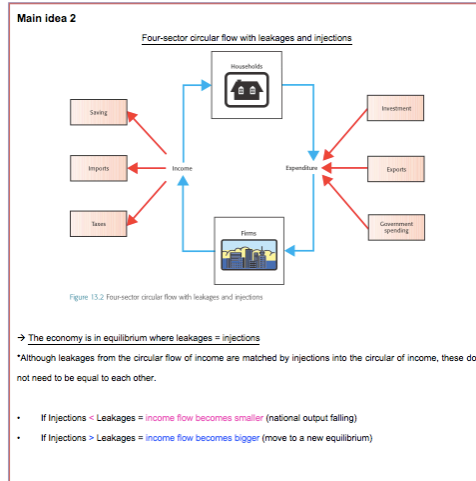
Webnote 213
Syllabus: 78-81 (HL 80)

SYLLABUS REFERENCE 2.1: Measuring National Income

Real + Nominal National Income /GDP ¹

Injections:

- G:** government
- I:** investment
- X:** exports

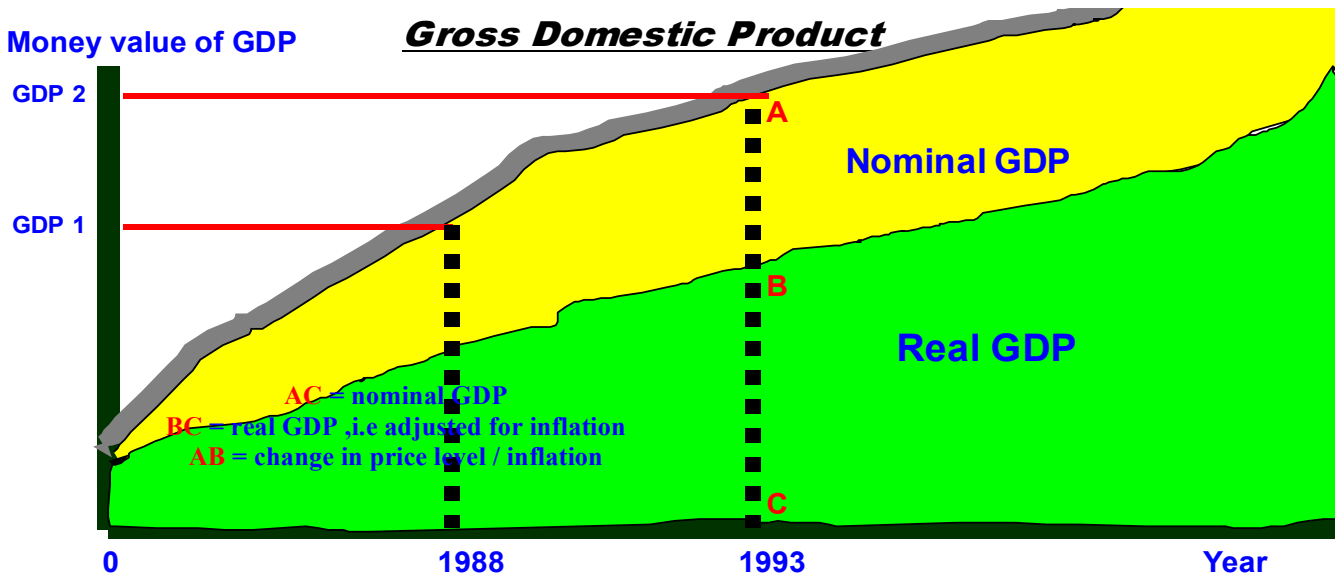


Leakages:

- S:** savings
- T:** taxes
- M:** imports



Big Question: How do we measure the performance of an economy ?



Core Reading: Glanville pp 208-223

Why do government use national income statistics?

- **Uses of NI stats: Who needs them?**
- ⊙ **Government. N.I. statistics are critical for management of the economy: see government objectives in managing an economy. The government needs to know how the economy is performing in terms of growth, unemployment and inflation in order to know which policies to adjust e.g. fiscal policy could be used to reduce inflation by increasing direct taxation**
- ⊙ **Firms: when to invest ? boom or trough?**
- ⊙ **Theoretical research. Economic Theory.**
- **Calculating real GDP from nominal GDP**
Suppose GDP of USA in 1993 was \$627 m showing an increase of 56 % over 5 years. Nominal figure will not take inflation into account. Inflation is 20 %.Using inflation as a deflator then the figure would be adjusted as follows:

$$627m \times \frac{100}{120} = 522m \text{ of real GDP}$$

Real National Income e.g. real GDP

Advantages

1. Allows government to observe if the economy is producing more goods and services
2. Allows government to remove the inflationary effect that appears in nominal national income
3. Business firms use the real national income statistics to make forecasts about demand and therefore this will influence their investment decisions
4. Economy can record the changes in the standard of living using the real gdp and this is one of the 3 key components in measuring development (+ health+education)
5. GDP data allows for international comparisons

Disadvantages:

1. Data can often be inaccurate as full tax returns may not be available and therefore the full extent of the incomes is not clear. Remember government ultimately measures the income via income tax returns but self employed may cause time lags to occur
2. Informal /black / parallel markets is not recorded. In Greece this is often estimated to be in excess of 20% of all economic activity
3. GDP often does not include damage caused by Externalities. See 'Green GDP' item 80 in syllabus
4. GDP is not the only component of development and quality of life may fall even if GDP is rising
5. Public goods such as defence spending does not improve the standard of living although the spending is included in GDP

IBQ May 2014
(b) Discuss the usefulness of real GDP per capita as a method of measuring the living standards of a country's population. [15 marks]

M14/3/ECONO/S
P1/ENG/TZ2/XX

National Income Definitions:

➤ **3** methods of calculating national income

1. **income (= all incomes)**
2. **output (= all output)**
3. **expenditure (= all expenditures)**

Note: all 3 = national income

HL3 (Higher level students only)

Calculate GNP/GNI from data supplied.

Calculate real GDP using a price deflator.

Definitions: know these key terms!

(1) GNP/GNI

- **GNP is Net property income from abroad add in income from domestic factors operating abroad and subtracts income from foreign owned factors operating within the nation state**
- **Gross National Income = Gross National Product**
- **Value of total output/income for a country for 1 year**

(2) GDP

- **GDP is all economic activity within the borders of the nation state. It includes economic activity from foreign owned firms operating in the domestic economy.**

(3) other useful terms

- **Nominal vs Real income (see page 1 above)**
- **Total versus 'per capita' income (per capita is per head of the population including dependants i.e. children, non working mothers etc)**
- **'Green GDP' = GDP – value of damage caused by environmental degradation (pollution)**