Measuring Domestic Output and National Income

Gross Domestic Product (GDP)

**Definition:**
GDP or gross domestic products: the market value of all final goods and services produced in a country in a given time period typically a year.

This definition has four parts:

1. Market value
2. Final goods and services
3. Produced within a country
4. In a given time period

**Market Value**

GDP is market value, goods and services are valued at their market prices

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Output</th>
<th>Market Value</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>3 sofas and 2 computers</td>
<td>$500 + 2 at $2000 = $5500</td>
</tr>
<tr>
<td>2</td>
<td>2 sofas and 3 computers</td>
<td>$500 + 3 at $2000 = $7000</td>
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**Final Goods and Services**

GDP is the value of the final goods and services produced.

A final good (or service) is an item bought by its final user during a specified time period.

A final good contrasts with an intermediate good, which is an item that is produced by one firm, bought by another firm, and used as a component of a final good or service.

Excluding the value of intermediate goods and services avoids counting the same value more than once.
Produced Within a Country
GDP measures production within a country domestic production.

In a Given Time Period
GDP measures production during a specific time period, usually a year.

GDP Computation:
There are two approaches of calculating GDP:

1. Expenditure approach

The economy is divided into four sectors: household, business, government, and foreign sector. The expenditure approach measures GDP as the sum of: consumption expenditure, investment expenditure, government expenditure on goods and services, and net exports.

C: Consumption: is the expenditure of the household sector. It includes spending on:

- Durable goods which last for more than one year: like furniture.
- Non-durable goods: like food, and clothing.
- Services: like work done by lawyers, and doctors.

I: Investment: is the expenditure of the business sector, including:

- All final purchases of machinery, equipment, and tools by business enterprises.
- All construction.
• Changes in business inventories

**Gross Investment versus Net Investment:**

**Gross investment** includes investment in replacement capital and in added capital. **Net investment** includes only investment in the form of added capital.

Net investment = gross investment - depreciation

**Depreciation means:** the decrease in the value of a firm’s capital

**G: Government Purchases:** are the expenditures of the public sector, these expenditures include:

1. Expenditures for goods and services that government consumes in providing public services
2. Expenditures for social capital such as schools and highways, which have long lifetimes.

**Xn: Net Exports:** is the differences between exports (goods and services sold to the foreign markets) and imports (goods and services produced and imported from abroad).  

\[ X_n = X - M \]  

(X:exports, M:imports)

• If (exports > imports), net export is positive,
• If (exports < imports) net export is negative
Computing GDP:

GDP = C + I + G + Xn
Questions:

1. What is meant by GDP?
2. Explain how to measure GDP using the Expenditure approach.