GDP 1 Flow
GDP

Income & The Expenditure Approach

The Circular-Flow Diagram

The Circular Flow

[Images of circular flow diagrams showing the flow of goods, services, money, and factors between households, firms, and factor markets.]
The National Accounts

- Households earn income via the factor markets from wages, interest on bonds, dividends on stocks, and rent on land.

An Expanded Circular Flow Diagram: The Flows of Money Through the Economy

Income from the Factor Market

<table>
<thead>
<tr>
<th>Income received by Households</th>
<th>Factors of Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages</td>
<td>Labor</td>
</tr>
<tr>
<td>Rent</td>
<td>Land</td>
</tr>
<tr>
<td>Interest</td>
<td>Financial Capital</td>
</tr>
<tr>
<td>Profit</td>
<td>Physical Capital</td>
</tr>
</tbody>
</table>
The National Accounts

- Via the *financial markets*, private savings is channeled to firms for *investment spending* (I).

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**An Expanded Circular Flow Diagram: The Flows of Money Through the Economy**

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**Investment Spending**

- Spending on productive physical capital and changes to inventories
  - Inventories seen as contributing to the future sales of the firm
    - Spending on additional inventory adds to Investment spending
    - Drawing down inventories is counted as fall in Investment spending
The National Accounts

- Government purchases of goods and services (G) is paid for by tax receipts as well as by government borrowing.

An Expanded Circular Flow Diagram: The Flows of Money Through the Economy

The National Accounts

- Exports (X) generate an inflow of funds into the country from the rest of the world
- Imports (IM) lead to an outflow of funds to the rest of the world. Foreigners can also buy stocks and bonds in the U.S. financial markets.
An Expanded Circular Flow Diagram: The Flows of Money Through the Economy

GDP = C + I + G + (X - IM)

- **C**: Consumer spending
- **I**: Investment
- **G**: Government
- **X**: Exports
- **IM**: Imports

What Is GDP?

- **GDP** is the nation’s expenditures on all **final** goods and services produced during the year at market prices.
The Flow Not Stock

- With GDP we are measuring a Flow or a movement NOT a Stock
  - The store of wealth is a stock concept.

A Stock Concept

How Much is a
Stock Concept

GDP is a flow concept
How GDP Is Measured?
Income (wages, salary, rent, interest, profits)

Firms

$\rightarrow$

Households

Expenditures by Consumers, Investors, Government, and Net Exports

How GDP Is Measured?
Income (wages, salary, rent, interest, profits)

$\rightarrow$

Firms

Same As

$\rightarrow$

Households

Expenditures by Consumers, Investors, Government, and Net Exports

How GDP Is Measured?
Income (wages, salary, rent, interest, profits)

$\rightarrow$

Firms

Value of what is produced

$\rightarrow$

Same As

$\rightarrow$

Households

Value of what is spent

Expenditures by Consumers, Investors, Government, and Net Exports

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How GDP Is Measured?

Income (wages, salary, rent, interest, profits)

Flow of Income Approach

Firms

Same As

Households

Value of what is produced

Expenditures Approach

Value of what is spent

Expenditures by Consumers, Investors, Government, and Net Exports

\[ GDP = C + I + G + X_n \]

The Components of GDP, 2000 (in $ billions)

- Consumption: $4,100
  - Non-durables: $2,000
  - Durables: $200
  - Services: $1,900
- Investment: $1,261
  - Fixed investment: $1,000
  - Residuals: $261
- Inventory change: $71
- Total = $6,439
- Government purchases: $5,740
  - Federal: $3,025
  - State and local: $2,715
- Net Exports (Xn): $1,800
  - Exports: $2,000
  - Imports: $1,200
- GDP: $9,956

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The Components of GDP, 2000 (in Billions)

- Consumption
  - Nondurable goods ........... 5,430
  - Nondurable goods ......... 2,300
  - Services ................. 1,729
  - Total C .................. 9,469

- Investment
  - Fixed & Equipment ......... 5,267
  - Residential Housing ..... 1,830
  - Inventory Change ........ 5
  - Total I .................. 7,102

- Government Purchases
  - Federal .................. 5,267
  - State and Local .......... 1,729
  - Total G .................. 7,096

- Net Exports (Net)
  - Exports ................. 5,100
  - Imports ................ 4,100
  - Net .................... 1,000

- GDP ...................... 13,918

GDP is a flow concept in Macroeconomics

Income Arm

Expenditure Arm

What's measured on the income side?

Income received by Households
- Wages
- Rent
- Interest
- Profit

Factors of Production
- Labor
- Land
- Financial Capital
- Physical Capital