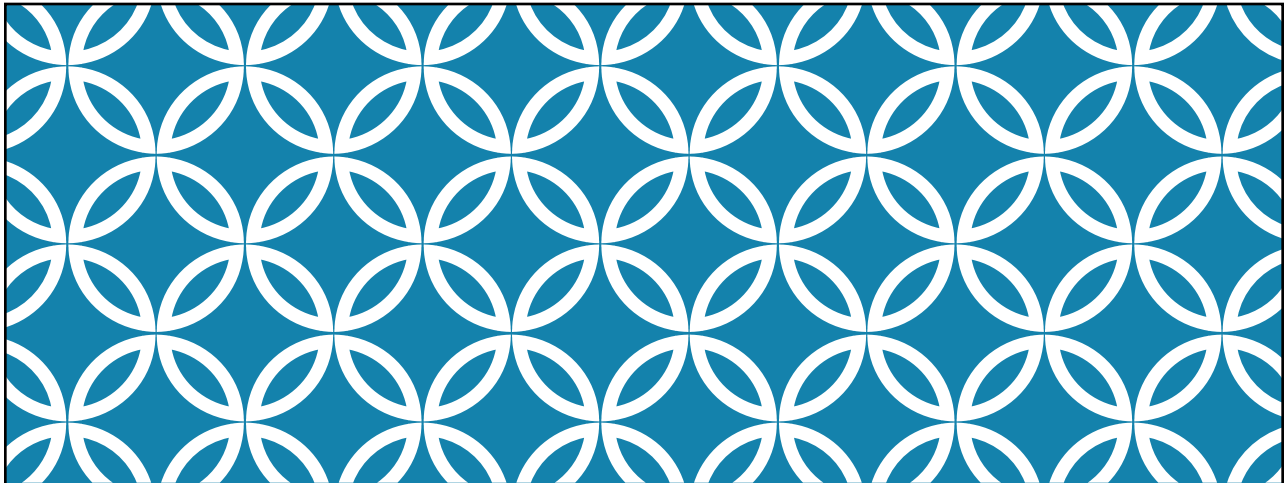




ECON 522, AUG. 28, 2017

PRODUCTION = INCOME = EXPENDITURE

Every dollar that a buyer spends becomes income to the seller.

Circular flow diagram

NATIONAL INCOME IDENTITY

$$Y = C + I + G + NX$$

Y = GDP (in dollars)

C = consumption

I = investment

G = government purchases

NX = net exports = exports - imports

INCOME ACCOUNTS

Gross National Product = market value of goods and services produced by a country's residents and factors of production owned by a country's residents. Measures total income earned by nationals (US individuals and firms) as opposed to total income produced domestically.

INDEX NUMBERS

Laspeyres Index = measure of the price levels based on a fixed basket of goods

- Example: CPI
- Weighted average of prices, where the weight on each price reflects that goods relative importance in the CPI basket. Weights remain fixed over time.
- Tends to overstate increases in cost of living. Substitution bias, introduction of new goods, unmeasured quality changes.

Paasche Index = measure of the price levels based on a changing basket of goods

- Weighted average of prices, where the weight on each price reflects that good's relative importance in GDP. Weights change over time.
- Tends to understate increases in cost of living.

INDEX NUMBERS

Fisher (Chain-Weighted) Index = an average of the percent change in the other index types

Chain-Weighting is used to calculate GDP.

- Real GDP – fixed price measure
- Nominal GDP – current price measure
- Chain Weighted GDP
 - Calculate the growth rates in both real and nominal between one point in time and the next
 - Find the geometric average of those growth rates to get the chain-weighted growth rate
 - Apply the chain-weighted growth rate to find the level of GDP
 - Computes RGDP in 2015 using both 2014 and 2015 prices, RGDP in 2016 using both 2015 and 2016 prices, etc.