## Accounting Of National Income and the Balancing of Payments-Overview

The GDP is the most significant macroeconomic metric tracked by economists and the media (GDP). This chapter also discusses whether it should be so significant. But first, the GDP must be defined and comprehended. This chapter describes the national income identity. It also shows the balance of payments, the twin-deficit identity, and the international investment status. These are the main factors in a global finance course.

### National Income and Product Accounts

### LEARNING OBJECTIVES

1. Define GDP and how it is used to assess economic health.

Understand GDP's limits as a well-being indicator.

The National Income and Product Accounts contain many important aggregate indicators used to define an economy (NIPA). National income is the entire amount of money earned by production factors in a year. This comprises salaries, rents, profits, and interest paid to employees and capital and property owners. The national product is worth an economy's production over a year. The market value of all commodities and services generated by enterprises in a country is termed the national product.

For many reasons, GDP should only be considered an approximate estimate of a country's wealth, and many argue that GDP is a poor indicator of country wealth. Listed below are reasons why GDP is not a good predictor of national welfare.

1. GDP solely measures the annual output of commodities and services, and it does not account for unused commodities and services. For example, second-hand automobiles, computers, furniture, and houses are valuable and generate welfare for years after production. But the value of these things is only included in the GDP year

of production. Unlike GDP, national wealth quantifies the value of all products, services, and assets available in an economy at a given moment.

2. GDP ignores the population it must sustain. To calculate per capita GDP, we divide GDP by the population, and this is how cross-country comparisons are commonly done.

3. GDP does not account for how the economy's commodities and services are allocated among its members. Lesser GDP with more fair distribution may be preferred over greater GDP with more concentrated wealth.

4. Price level increases (inflation) would enhance measured GDP and overestimate the growth in standard of living. So even if the economy produces the same number of goods and services but prices rise, GDP rises. Thus, real GDP is commonly employed to estimate GDP growth. Real GDP is calculated by dividing nominal GDP by the price level.

5. High GDP economies may also create substantial negative output externalities, such as pollution. So a lower GDP with less pollution is preferable to a greater GDP with more pollution. Some claim that high GDP growth may lead to resource depletion, which is unsustainable in the long term.

6. GDP frequently increases following natural calamities, and economists anticipated Japan's GDP would grow faster following the Kobe earthquake in the 1990s. In part, this is due to the need to replace destroyed structures, demonstrating why GDP growth is not always indicative of a healthy economy.

7. GDP represents economic output rather than consumption, which is crucial for economic health. As demonstrated later, when a country's trade balance is zero, its national production equals its consumption; when it is negative, national consumption exceeds production. Because spending is enjoyable but producing is not, national consumption should be used to assess economic health rather than GDP.

**KEY LESSONS**

• GDP is the value of all final products and services produced inside a country's boundaries throughout a year.

GDP is measured as the total of expenditures in many broad spending categories. GDP = C + I + G + EX - IM.

Personal consumption expenditures (C) are goods and services purchased by household inhabitants. Services, commodities that cannot be kept and are utilized at the moment of purchase, are classified into durable goods and nondurable products. Domestic families also consume foreign goods and services.

**Imports and the National Income Identity**

It is critical to clarify why imports are reduced from national revenue to avoid significant misunderstandings. First, the identity can lead one to believe that imports are eliminated because they harm the economy. This debate frequently arises due to the traditional political emphasis on jobs. This means that things that might have been manufactured locally are now manufactured elsewhere. An opportunity cost to the economy may justify excluding imports from the identity. But this is false.

The second error is to exploit the identity to establish a link between imports and GDP growth. Thus, economists frequently state that GDP expanded less than predicted previous quarter due to higher imports. The identity implies this relationship since rising imports reduce GDP. But this view is incorrect.

**KEY LESSONS**

- GDP investment measures physical, not financial, investment.
- All levels of government are commodities and services.
- As part of consumption, investment, government spending, and exports, imports are subtracted from national revenue.
- Imports have no impact on GDP. Increasing imports does not reduce GDP.

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