Principles of economics gross domestic product

Principles of Economics Gross Domestic Product Martin Sharkey Western International Questions What is the difference between real GDP and nominal GDP Does GDP accurately reflect our nation's productivity Explain your answer.

Answer and Explanation

Because GDP measures the total spending on goods and services in terms of money over a particular period, it is important to note that prices are not constant over time. To reflect this dynamics and in order to make realistic comparisons between GDP figures over the years, economists have introduced two measures for GDP. Nominal GDP measures the produced goods and services at current prices during the year, whereas real GDP measures them at a constant price. This means that in calculating real GDP, economists take one year as a base year, and knowing the quantities of products and services over the years, calculate the value of GDP at the prices from the base year. During the base year nominal and real GDP are equal. Therefore real GDP reflects both prices and quantities of goods and services produced by an economy, whereas nominal GDP reflects the produced quantities only.

GDP does not reflect accurately the nation's productivity. There are products that GDP excludes, because it is difficult to measure them. For one thing, GDP includes all items produced and sold legally in the market. This means that products that are produced and sold illegally cannot be traced and measured by the GDP. Additionally, GDP does not include products and services that are actually produced by households but never enter the market. These are, for example, home grown fruit or vegetables that are used within the households that cultivate them. Also, GDP excludes other immeasurable variables like the quality of the environment or leisure time and does not reflect the distribution of income within an economy.

Reference:

Mankiw, G. (2004) " Chapter 23. Measuring a Nation's Income" Principles of Economics pp. 499-518.