Lower division capstone

Business

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Introduction

Gross Domestic Product(GDP) usually refers to the market value of the goods and services which have been produced in the country during a specific period (Sullivan, 2008). GDP was initially developed by Simon Kuznet for a report which was to be presented to the US congress in 1934. (Kuznets, 1934)

GDP Calculation

There are three basic ways to calculate GDP for any country- product method, the income method and the expenditure method.

Product Method

The product method of calculating GDP is also known as the Net product or the value added method.

For calculating GDP according to this method first of all the gross value of domestic output in various economic activities is estimated. Once this has been done, we need to deduct the intermediate consumption from this so that only the final value of all the economic activities is taken into account. (Barro, 2008)

E. g.-Let we consider an economy which only has a farmer, a flour factory and a baker

1) Value added by a farmer = Wheat – Cost = 6$

2) Value added by flour factory = flour-wheat= 11-6= 5$

3) Value added by baker = Bread –Flour = 14-11= 3$

So the total GDP of the country comes out to be 14$

Income Method

In this method of calculating GDP; we take into account the total income of the country during a particular time frame. According to this method,

GDP = R + I + P +A+S (Barro, 2008)

Where;

R = total income from rents in the country

I= Total income earned from interests

P = Total profit of all the organizations of the country

A = Adjustments like corporate income tax, dividends etc.

S = Salary earned by all the employees.

Expenditure Method

The expenditure method of calculating GDP concerns with measuring all the expenditure that has been undertaken by both private and public institutions as well as individuals. (Barro, 2008)

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

Where;

C = Private Expenditure

I= Investments

G = Government Spending

X= Value of exports

M= Value of Imports

Interpreting GDP

GDP data provides a good overall picture of the way in which the economy of the country is moving forward. We will mention in this paper some of the applications of GDP-

Measuring and Comparing Growth

GDP is a very important factor which tells the state of an economy. Recession is usually around the corner when GDP has been shrinking for two quarters in a row. Country is usually seen to be recovering back from recession when GDP starts growing again. A high GDP growth country usually attracts a lot of investments.

Comparing Prosperity

GDP per capita is regarded as an indicator of the overall well being of the citizens of a country. China and India have high GDPs but their GDP per capita is low which is consistent with the millions of poor and malnourished in these countries.

Output Composition

The output composition of GDP gives an indication of the type of economy that a country has. A country following an aggressive form of development is most likely to be spending most on investment and very little on consumption. If the GDP data is collected according to various industrial and sectoral categories we can get great insights into the composition of the economy.

Expected US GDP

Normally after a recession just like the one that the country recently witnesses we expect a period of renewal with a high GDP growth . But this time the GDP growth rate has been very lackluster which has raised fears of a double dip recession. GDP as well as total consumer spending in US has

declined sharply during the first quarter of 2011 as can be seen from the graph below.

A lot of speculations have been made regarding the impediments to the slow growth of GDP during 2011..

Let us now consider various factors which might help in the potential recovery of the GDP in the near future.

1) Decreasing House Debt

The crisis that started a few years ago was largely due to the housing bubble. The great news is that the debt has been reducing continuously and has now reached levels of 1980s and 90s. The burden of debt at present is not too high and will certainly not hamper growth to a large extent (Tilton, August 2011).

2) Cyclical Sectors set to recovery

Household and auto sector were one of the most severely hit sectors during recession. However these sectors are cyclic in nature and are expected to regain some of their lost vigour. This will certainly help in boosting the economy of the country. (Tilton, August 2011)

3) Relief in Gasoline Prices

Although gasoline prices have remained very high; the prediction is that we are likely to see some relief in this sector which might help growth a little. (Tilton, August 2011)

4) High Fiscal Deficit of federal government

The high deficit of the US government was one of the main reasons why USA lost its AAA rating recently. The federal government really needs to tighten its budget in order to control the fiscal deficit. However a drastic reduces in government spending may lead to a negative effect on the economy as it

might further stifle the already low economic activity. The government has made some initiatives like introducing the new military retirement plan in order to reduce its liabilities but many more such initiatives need to be taken up. This is the factor which will affect the economy most in the times to come. (Office of the management and Budget, 2011)

Taking althea above factors in to consideration; US GDP is not likely to rise very rapidly and we are not going to see an easy escape route from the current crisis. However the chances of recovery t present are much more than they were a year before.

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