

Economics essay on economic growth (nominal gap)

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Discuss 4 reasons, why using percentage change in Nominal GAP is an inadequate measure of Economic Growth? Nominal GAP (Gross Domestic Product) measures the total value of goods and services produced by an economy over a period of time, which is normally one annum, and is not adjusted. There are factors which means that the fact the Nominal GAP is not adjusted makes it an inadequate measure of economic growth.

Economic growth is the increase in the amount of the goods and services produced by an economy over time, and both positive and negative growth can be shown on a production possibility frontier.

Positive capacity growth negative capacity growth

The most important factor making Nominal GAP inaccurate is the influence of inflation as it can have such a large effect on the GAP meaning that excluding it is inexact. Furthermore, the effect of population Growth in any country can also change the GAP and because the Nominal GAP does not account for this it becomes less reliable. Moreover, an increase in quality in goods and services as well as the illegal and black markets can also change the GAP.

The effect of inflation on GAP is the main factor that makes Nominal GAP inaccurate. Inflation means a sustained increase in the aggregate or general price level in an economy. Inflation means there is an increase in the cost of living. The I-J at the moment is experiencing an inflation of 3%, the effect this has on GAP is significant. For example if the Nominal GAP figure has shot up 8% but inflation has been 4%, the 'Real GAP' has only increased 4%.

However, the Nominal GAP figure would still show 8% economic growth and that isn't accurate.

Furthermore, it makes it a problem to check the value of goods and services because a rise in general price level can make it look like a production of goods has increased when in fact it is just inflation. This is one of the main reasons why the Nominal GAP in the I-J in 2012 was \$2, 429, 184 but is likely to be much less (as illustrated in the graph). However, the statisticians use the " Real GAP' to make figures more accurate, which is an inflation-adjusted measure that reflects the value of all goods and services produced in a given year.

This is more accurate because, for example, in 2012, (say if) Nominal GAP is \$200 billion. However, due to an increase in the level of prices (inflation) from 2009 to 2012, 'Real GAP is actually \$170 billion. The row " Real GAP' reflects the price changes while nominal does not, and " Real GAP' is therefore more accurate. Another substantial influence on the accuracy of Nominal GAP is population growth. If the population rises, you can expect total GAP to also rise since, some of the new members of the population will be engaged in productive output increasing the quantity and productivity of production.

This, of course, would increase the Nominal GAP, which is a reason why London in particular, which sees its economics essay By Gentrification population growth makes a Nominal GAP value imprecise is because the people are to only producing, they are also consuming, and this consequently, will mean that the average standard of living is falling.

Furthermore, GAP takes no account of externalities. Externalities occur when a market fails to fully account for the social impact of production and consumption.

For example, an economy may enjoy high levels of growth during a period of industrialization but will experience an opportunity cost of the environment. Therefore population growth can distort GAP figures because it will artificially increase GAP but may not reflect standard of living. This is why economists use GAP Per Capita. GAP Per Capita is a measure of the total output of a country that takes the Nominal GAP and divides it by the number of people in the country (which in the UK is 63.7 million people). The Per Capita GAP is useful when comparing one country to another because it shows the relative performance of the countries.

A rise in Per Capita GAP signals growth in the economy and tends to translate as an increase in productivity. Another reason why economists opt to use Per Capita GAP is that, the GAP is one of the primary indicators of a country's economic performance. It is calculated by either adding up everyone's income during the period or by adding the value of all final goods and services produced in the country during the year. However, Per Capita GAP also accounts for standard of living, with a higher Per Capita GAP being interpreted as a country having a higher standard of living.

The GAP Per Capita in the UK in 2013 is \$38,002 which gives a more accurate value when comparing the I-J with other countries. This also means that countries with a huge population such as China do not get an unfair advantage in global standings as it will be relative to population meaning

smaller countries such as the I-J can compete. The quality of the goods being produced can also distort Nominal GAP value. What is apparent is that from time to a company such as Samsung or Sony introduce a next gene product for around the same relative price as an earlier product.

Take the Samsung Galaxy models for example. The Samsung Galaxy S0 was introduced in May 29, 2012 and the original price was \$600 in the US, however the Samsung Galaxy S0, which came out on the 1st July 2013, had a superior screen faster system and better quality camera, yet was priced at \$550 initially. This means that the next gene hone would surely improve the quality of one's life but as the phone is produced and sold at a cheaper price the Nominal GAP data would suggest a collapse in growth rather than an increase in the standard of living.

Economists find it difficult to actually do anything about this as it is difficult to measure how quality of goods effect standard of living, however they may just refer to GAP Per Capita as it is the value of all final goods and services produced in the country during the year. Furthermore economists may say that when a product becomes cheaper, and because it is a better product than its predecessor, demand, in turn, goes up than of course need for supply goes up, and the answer to what that does for GAP is that it increases the number of workers needed for that product.

In addition, the price goods are sold at in different countries can be a problem. The Phone 5 in the United Kingdom sells for around £771 which is the equivalent of \$871; however in the USA the phone 5 is sold for around \$630 even though the quality of the product is the same. This may not seem

like a big problem but with the Nominal GAP of a country, and the same applies for many gadgets. With nonusers benefiting from falling prices with better quality goods a double gain, the nominal GAP would measure this output lower due to lower price, suggesting that the value of output has fallen, thus making the nominal GAP less accurate.

The final factor to discuss is the effect of the black and illegal markets on GAP and how GAP cannot actually be measured to account for it. The Black Market is type of economy that takes place outside of government-sanctioned channels. Black-market transactions typically occur as a way for participants to avoid government price intros or taxes, conducting transactions 'under the table. ' The black market is also the means by which illegal substances or products such as drugs, firearms or stolen goods are bought and sold. However its impact is more that thought.

In the I-J the black market is said to account for 10% of the economy which is a huge proportion. Black market transactions are not accounted for in the Nominal GAP figures. This is particularly important to note when looking at third world countries that may have a significant part of their economy involved in the sale of black market goods, in which ease their level of productivity would not be accurately reflected by looking at GAP. In countries such as Thailand and Nigeria the black market is said to amount to 70% of the total economy.

This of course could mean that if accounted for the black markets of these countries could make their potential GAP much higher than it may seem. However in this case economists can't actually account for this when

calculating the GAP because it is undeclared, instead the economists state that in Nominal GAP figures they exclude illegal black and domestic markets. However the effect of inflation is the most important factor making the Nominal GAP unreliable because as shown in the graph (on page 1) it can make the Nominal GAP look much higher than it should be.

Furthermore inflation directly affects the Nominal GAP and its solution, the 'Real GAP is a fairly reliable. In 1990-2003 the nominal GAP had increased by 558, 160 million too total of 1. 1 billion. However 1. 1 billion now is worth less than it would have been in 1990 simply because of inflation in the meantime. However the effect of population growth is also very reliable so economists tend to use the " Real GAP Per Capita' as the most reliable source to measure economic growth as it accounts for standards of living as well as inflation.

To conclude the percentage change in Nominal GAP can only go so far as an indicator of economic growth. This is because of the factors discussed above, inflation, population growth, quality of goods and services and the black and illegal markets. Economists have managed to think of alternative ways to measure economic growth by altering the GAP to show the effect of inflation in the 'Real GAP as well as the standards of living and effect of population sing GAP Per Capita, but are unable to find an accurate way to show the effect of the black and illegal markets.

Things not discussed that I could have mentioned. Nominal GAP (and even 'Real GAP per Capita') data does not reflect income inequality - Real GAP Per Capita data shows an average income per person. But the averaging process

may mask inequality. Imagine a very simple economy with 10 households is split equally (\$40, 000 per house) than if there is a high degree of inequality (one house with \$310, 000 and the rest on \$10, 000 each). Thus any assessment of the average standard of living using GAP data requires an examination of modal and median income levels in addition to mean income.

Comparing GAP between countries requires exchange rate - the exchange rate is the value of currency in terms of another currency. When comparing GAP of France and the I-J, for example, it is necessary to convert French GAP from euros to sterling. But choosing the correct exchange to use can be controversial and potentially distorting. The economist magazine periodically publishes the Big Mac Index, which compares the prices of a burger in one country to another.