David Youngberg
ECON 201—Montgomery College

LECTURE 21: GDP III

I. Business Cycle
   a. The economy goes through periods of expansion and contraction. We call this pattern the business cycle.
   b. *Recession*—a significant, widespread decline in real income and employment
      i. National Bureau of Economic Research (NBER) defines it as two consecutive quarters of a decline in GDP, along with other considerations (e.g. for purposes of determining which exact month/week the recession occurred).
   c. Whom the recession hits the most
      i. When a recession hits, sales of toilet paper and alcohol don't change that much (though the type of alcohol people buy does change). What should change the most?
      ii. Things that people can put off buying, whether because they can stretch what they currently have or because they can do without one at all for a bit longer. These tend to be consumer durables and capital goods
   d. Thus, an increase in private investment and consumer durables is a good sign of an economic recovery.

II. Complexities
   a. There are many things GDP <u>*should*</u> count but doesn't due to logistical reasons. Thus we shouldn't naively depend on GDP as our measure for how wealthy a country is. It's useful information but not the whole story.
   b. *Extralegal*. Because of the obvious logistical barriers, it doesn't count illegal activity such drugs, prostitution, bribes, and counterfeit DVDs. In some countries, the change GDP is relatively small (but can still be 10-20% of GDP). But in many developing countries, the extralegal sector is <u>huge</u>: economists estimate Latin America's GDP to be more than 40% larger than measured.
   c. *Nonmarket Production*. Many people do valuable work without getting paid. For example, a stay-at-home parent takes care of a child without a market transaction. If the family hired a nanny, a transaction would take place and GDP would increase.

        i. This creates problems of analysis both across time and across countries. Many more women work in the U.S. now than 50 years ago; this increases GDP even though all that's really happening is that people are changing jobs. Similarly, many people in developing countries did everything from building their own homes to growing their own food. They are poor compared to the U.S., but the GDP per capita suggests they have less than they actually do.

d. *Leisure*. If you go to a movie, you increase GDP but if you chat with your friends, you don't. Free time is very valuable, but because there's no transaction, it's not included (much like nonmarket production).
    i. Thus countries where people take more vacation time seem poorer than they really are. Like the previous point, this also has implications across time.

e. *Environmental Costs*. Just because you produce a lot doesn't mean you are wealthy. If your country is heavily polluted as a result of that production, you might prefer a "poorer" country than yours.

f. *Income Distribution*. A country's GDP would be the same if everyone earned the same amount of money or if one person gets the entire GDP as income. When GDP grows, it will disproportionately help those with the most income (all other things being equal).
    i. Thus countries with a higher GDP per capita doesn't necessarily mean a typical person is wealthier than a typical person from a country with a lower GDP per capita.