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LECTURE 17: GDP III

I. Business Cycle
   a. The economy goes through periods of expansion and contraction. We call this pattern the business cycle. The most notable part of this cycle is the recession.
   b. *Recession*—a significant, widespread decline in real income and employment.
      i. National Bureau of Economic Research (NBER) determines when a recession occurred. Note the past tense: the NBER does not cause recessions; it merely records when recessions officially began and when it officially ended.
      ii. How does it do this? Members look at a lot of different indicators, the biggest one being GDP. But others indicators involving industries that are particularly hit hard by recessions are helpful.
   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. Luxury goods and services are particularly hit hard during recessions because people don't need to buy them.
      iii. Things that people can put off buying because they can stretch what they currently have are also hit particularly hard. These tend to be consumer durables and capital goods, especially "big ticket" items like cars and large pieces of equipment.
   d. Thus, an increase in private investment and consumer durables is a good sign of an economic recovery.

II. What GDP Is and What It Isn't
   a. There are two things GDP *should* 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.
      i. *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 huge: economists estimate Latin America's GDP to be more than 40% larger than measured.

   ii. *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.
      1. 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.

b. GDP also has limits as a measure of wellbeing. While it's helpful to compare GDP (or more accurately, GDP per capita) across countries, it's important to understand that it doesn't include everything people find valuable.
   i. *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).
      1. Thus countries where people take more vacation time seem poorer than they really are. Like the previous point, this also has implications across time.
   ii. *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.
   iii. *Income Inequality/Mobility*. GDP does not include measurements of how evenly or unevenly wealth is distributed or how easy it is to climb out of poverty. These are certainly important considerations but we have ways to measure them, such as the Gini ratio.
      1. Note, and this is important, that you really need to think about both. The poorest people in rich but unequal society might be better off than the poorest people in a poor but equal society.