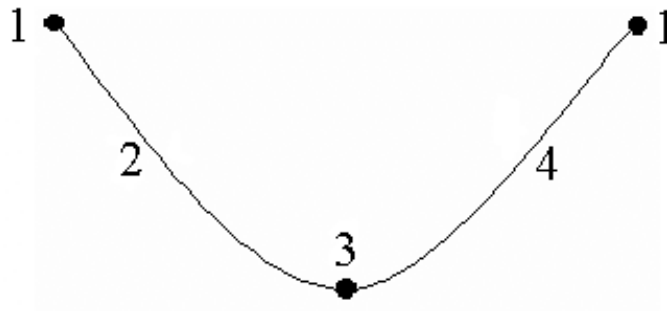


Economic Performance

A. Gross Domestic Product

1. Gross Domestic Product (GDP) – the total market value, expressed in dollars, of all final goods & services in an economy in a given year
 - a. GDP can be calculated by adding up all sales of final products, or with minor adjustments, by adding up all income paid to the factors of production
 - (1)
 - (2)
 - b. GDP is not a perfect measure of how well-off people are
 - (1)
 - (2)
2. Nominal GDP is stated in current prices, so an increase in GDP may reflect not only increases in the production of goods & services, but also increases in overall prices
 - a. GDP can be adjusted for price level changes, which results in a statistic called *real GDP*
 - (1)
 - (2)
 - b. Measures of *per capita real GDP* (real GDP divided by population) are often compared across countries to evaluate the performance of economies & the well-being of citizens, but this approach does not account for differences in the types of goods produced or in the distribution of income
3. In the U.S. & other industrialized economies, the rate of economic growth over long periods of time has been relatively steady, but short-run fluctuations in business activity are not smooth nor completely predictable
 - a. Business cycle – a recurring pattern in economic activity that is characterized by alternating periods of expansion & contraction



(1) Economic peak

(2) Contraction (bust)

(3) Trough

(4) Expansion (boom) (begins as recovery)

b. Recession vs. Depression

(1) Recession

(2) Depression

c. There are 3 types of economic indicators used to help predict the business cycle

(1) Leading indicators

(2) Coincident indicators

(3) Lagging indicators

d. Governments may attempt to reduce the fluctuations of the business cycle by implementing policies that can affect the level of real GDP

B. Aggregate Supply & Aggregate Demand

1. Aggregate Demand (AD) – the total spending for all types of goods & services in the economy & it equals consumption, investment, & government spending, plus net exports (C+I+G+(X-M))

a. AD can also be determined by multiplying together the *stock of money (M)* & the *velocity of circulation (V)* (M x V)

(1) Stock of money

(2) Velocity of circulation

- b. AD changes when there are changes in consumer, investment, or government spending, in net exports, or in price expectations
 - (1)
 - (2)
- 2. Aggregate Supply (AS) – the total quantity of goods & services produced in the economy & is the same thing as *real GDP*
 - a.
 - b.
- 3. Since one person’s spending becomes another person’s income, the relationship between potential AS & AD is an important determinant in the levels of unemployment & inflation in the economy
 - a. When AD is equal to AS at a level that just employs all available productive resources with no changes in the overall price level, the economy is at a full-employment, non-inflationary equilibrium
 - (1)
 - (2)
 - b. These changes in AD have an effect on the amount of ***disposable income*** (income available for use after taxes have been paid), which is either spent or saved

C. Unemployment

- 1. Unemployed people are those who are willing & able to work at current wage rates, but do not have jobs
 - a. Unemployment implies that the nation is not using its scarce resources as effectively as possible
 - (1)
 - (2)
 - b. The rate of unemployment is affected by the costs & benefits of searching for a job
- 2. Unemployment rate – the percentage of the ***labor force*** (composed of people age 16 & over who are either employed or actively seeking work) that is without work but actively looking for work

- a. The unemployment rate rises during a recession & is usually a sign that all is not well with the economy
 - (1)
 - (2)
- b. The standard measure of the unemployment rate is imperfect
 - (1)
 - (2)
 - (3)
- c. Full employment – when about 93 – 95% of the labor force is employed
- 3. There are 4 types of unemployment
 - a. Frictional unemployment
 - b. Structural unemployment
 - c. Cyclical unemployment
 - d. Seasonal unemployment
- 4. The government can adopt policies that attempt to counter specific types of unemployment
 - a.
 - b.

D. Inflation

- 1. Inflation – a sustained increase in the average price level of the entire economy; Deflation – a sustained decrease in the average price level of the entire economy
 - a. Inflation causes the prices of goods & services to rise & the purchasing power of the dollar to decrease
 - (1)
 - (2)
 - b. Inflation affects consumers' standards of living
 - (1)
 - (2)

- c. The economy can usually adapt to gradually rising prices, but high unpredictable inflation has very negative side effects on the economy, like tending to result in increases in interest rates on loans
- 2. Economists classify inflation into 2 general categories based on the cause: demand-pull & cost-push
 - a. Demand-pull inflation
 - (1)
 - (2)
 - b. Cost-push inflation
 - (1)
 - (2)
 - c. Regardless of its cause, inflation is monitored in the economy predominately through the *Consumer Price Index (CPI)*
 - (1)
 - (2)
- 3. There are a variety of policy options available to combat inflation, including monetary & fiscal policies, wage & price controls, antitrust actions, tax incentives, & automatic adjustment mechanisms
 - a. Many economists believe that there is a trade-off between unemployment & inflation, at least in the short run
 - (1)
 - (2)
 - (3) Stagflation
 - b. People tend to form expectations using both past experiences & predictions about present & future government policies, which may have an impact upon the effectiveness of government policy actions