Gross Domestic Product (GDP)

Gross domestic product, or GDP, is the money value of the final goods and services produced inside a country during a set period, such as a quarter or a year. People quote it when they say the economy grew or the economy shrank. This video shows what the number counts, what it leaves out, and how to tell a rise in prices from a rise in production.

1. What GDP counts

GDP adds up final goods and services made inside the country's borders in that period. A final good is one bought by the user, not a part that will be turned into something else. The count follows the place of the work, not the passport of the owner. Gross means we have not yet subtracted the wear on machines and buildings. Public schools and defense are included too, even though nobody buys them at a shop counter.

Example: A baker sells a loaf to a neighbor, and that sale is part of GDP. The same baker bakes the same loaf for the family dinner, and that loaf is not sold, so it is not counted. The wheat and the flour inside the sold loaf are not added again on top of the loaf. Only the loaf, the final good, enters the total.

At work: Omar runs a furniture plant in his own city, and a foreign group owns it. The desks made there this year are part of his country's GDP, because the work happened inside the border. His cousin builds kitchens in another country, and that pay stays out of this GDP. Omar now names the rule: what GDP counts is the place of the work, not the name of the owner.

2. Count it once

If we added the wheat, the flour and the loaf, we would count the same bread more than once. The way out is value added, which is the value of what a producer makes minus the value of the goods and services used up in making it. The farmer adds the wheat, the mill adds the step from wheat to flour, and the baker adds the step from flour to loaf. Statisticians can also add up what final users spend, or add up the incomes earned from making the goods, and these routes are built, in principle, to describe the same total.

Example: A wooden desk is the picture. The timber yard, the workshop and the shop each add one step. The customer pays once, and the rule, count it once, keeps that one payment rather than a fresh copy for every step.

At work: Omar's buyer asks why the timber purchases are not extra production on top of the desks. Omar names the rule: count it once. The timber is an input that is used up, and the desks are the final good.

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3. What GDP leaves out

A bigger GDP is not the same thing as a better life. Unpaid work at home, and most volunteer work, stays outside the number, because it is hard to put a price on it. The number also says nothing about who receives the income. A country can show a high GDP while many people gain very little, or while the extra output harms the air and the water.

Example: Two streets eat the same dinner. On one street people cook at home, and on the other they pay a restaurant. The restaurant street shows a higher GDP for the same meal, which is what GDP leaves out.

At work: Omar's director cheers a rising GDP and talks about hiring. Omar asks what GDP leaves out. The national number does not say whether his own customers have more to spend, or whether the rise sits in another sector. He asks for the plant's own orders before he agrees to hire.

4. Prices or more goods

Nominal GDP prices the goods at the prices of that same period. It can rise because the country made more, because prices rose, or both. Real GDP takes the price change out, so we can see whether production itself grew. When someone says the economy grew, the useful question is whether they mean real GDP.

Example: A town sells the same number of loaves this year as last year, and each loaf costs more. Nominal GDP for those loaves rises. Real GDP stays flat, because no extra loaf was baked. The gap between the two figures is the price change, not more bread.

At work: The news says GDP is up, and the director wants a larger sales target. Omar separates prices from more goods. The plant sold the same count of desks, and each desk costs more because the timber costs more.

Conclusion

GDP is the money value of final goods and services produced inside a country in a period. Count each thing once, remember what the number leaves out, and ask whether a rise is more goods or only higher prices. The figure describes the whole country, not one plant's next order book. Read it, then look at your own customers.

Sources

- Tim Callen, International Monetary Fund, Finance and Development, "Gross Domestic Product: An Economy's All" (final goods, borders versus nationality, the family loaf, gross versus wear, three approaches, real versus nominal, what GDP does not show) – https://www.imf.org/external/pubs/ft/fandd/basics/14_gdp.htm
- U.S. Bureau of Economic Analysis, "Gross Domestic Product" (final goods and services, real or chained versus current-dollar or nominal) – https://www.bea.gov/resources/learning-center/what-to-know-gdp
- Omar, the furniture plant, the two streets, the town's loaves and the prices in the examples are invented for teaching. No national statistic is stated.

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