



Macro Topic 2.1

The Circular Flow and GDP Practice

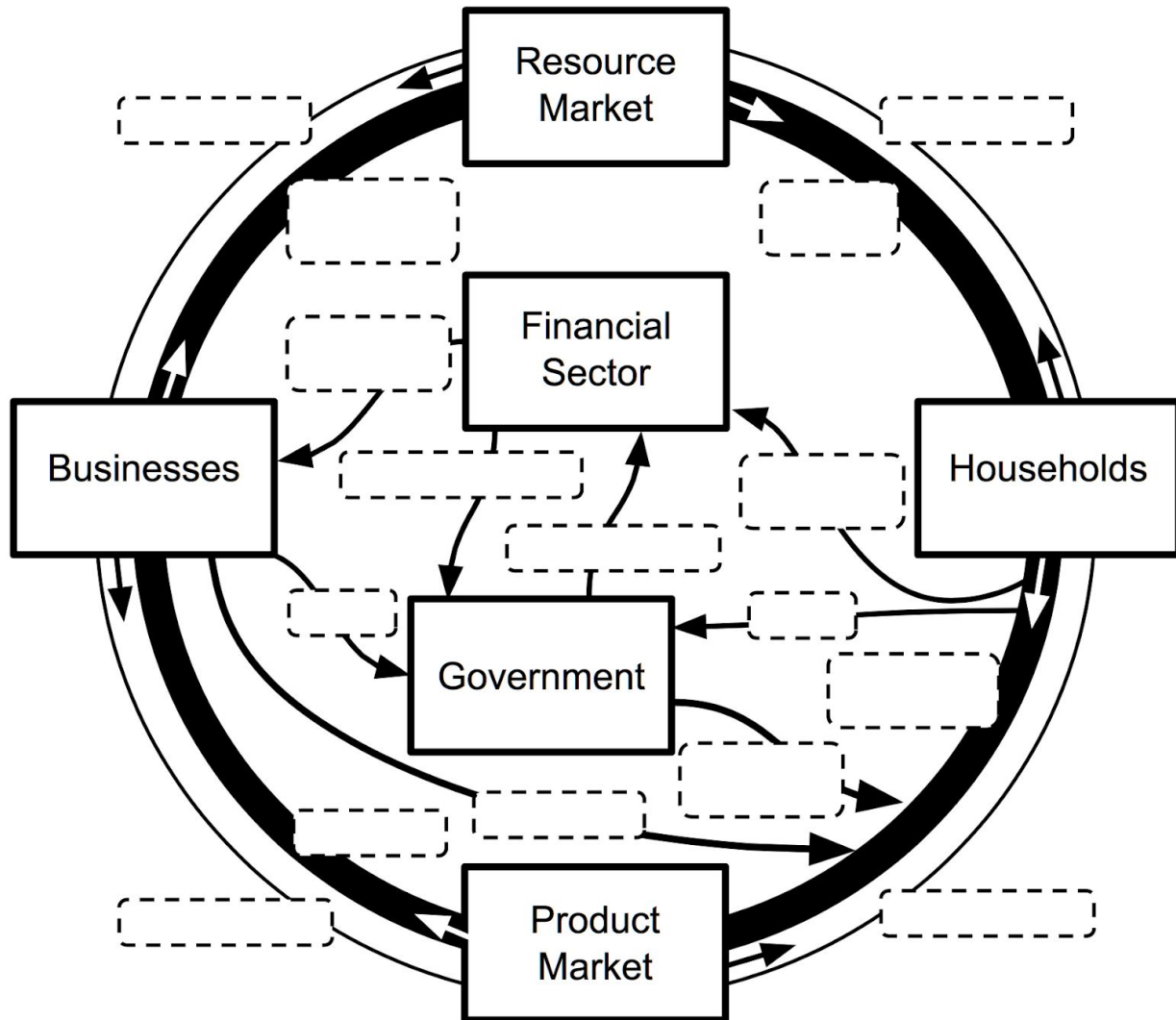
Part 1: Check Your Understanding- Use the word bank below to fill in the blanks on the circular flow diagram for a closed economy.

Consumption
Government Spending
Factor Payments

Goods/Services (2)
Investment
National Income

Private Borrowing
Private Savings
Public Borrowing
Taxes (2)

Public Savings
Resources (2)
Revenue



1. What are the four components of GDP using the expenditure approach?
2. What are the four components of GDP using the income approach?
3. Explain why both the expenditure approach and income approach yield the same value of GDP.



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4. What are government transfer payments and why are they not included in the calculation of GDP?
5. Why are financial transactions not included in the calculation of GDP?

Part 2: Practice- Identify if each of the following is an example of consumer spending (C), investment spending (I), government spending (G), net exports (XN), or not counted in GDP (NC) for the USA.

6. ___ You purchase a pizza for \$10
7. ___ A pizza restaurant spends \$4000 on advertising
8. ___ The government of Egypt buys 20 fighter jets from the US
9. ___ The US government offers a \$1000 tax rebate for purchasing a fuel efficient car
10. ___ A college student pay \$15,000 for tuition
11. ___ The US postal service builds a new building in Washington DC
12. ___ Harley-Davidson builds 200 motorcycles in Mexico and sells them to people in Europe
13. ___ Your friend helps you move into a new apartment
14. ___ Your family builds a new home in Wisconsin for \$450,000
15. ___ An American retail company spends \$3 million on Chinese toys

Part 3: Put It All Together- The table below lists the costs and prices for four businesses involved in making, distributing, and selling a ton of tomatoes. Use the information to answer the questions below.

	Cost of Inputs	Price of Output
Farmer Fred	\$0	\$150
Trucker Tom	\$150	\$250
Distributor Dave	\$250	\$400
Retail Rob	\$400	\$450

1. Calculate the GDP using value-added approach. Explain how you got your answer.
2. How much is the GDP using the expenditure approach? How is this process for calculating GDP different than the value-added approach?



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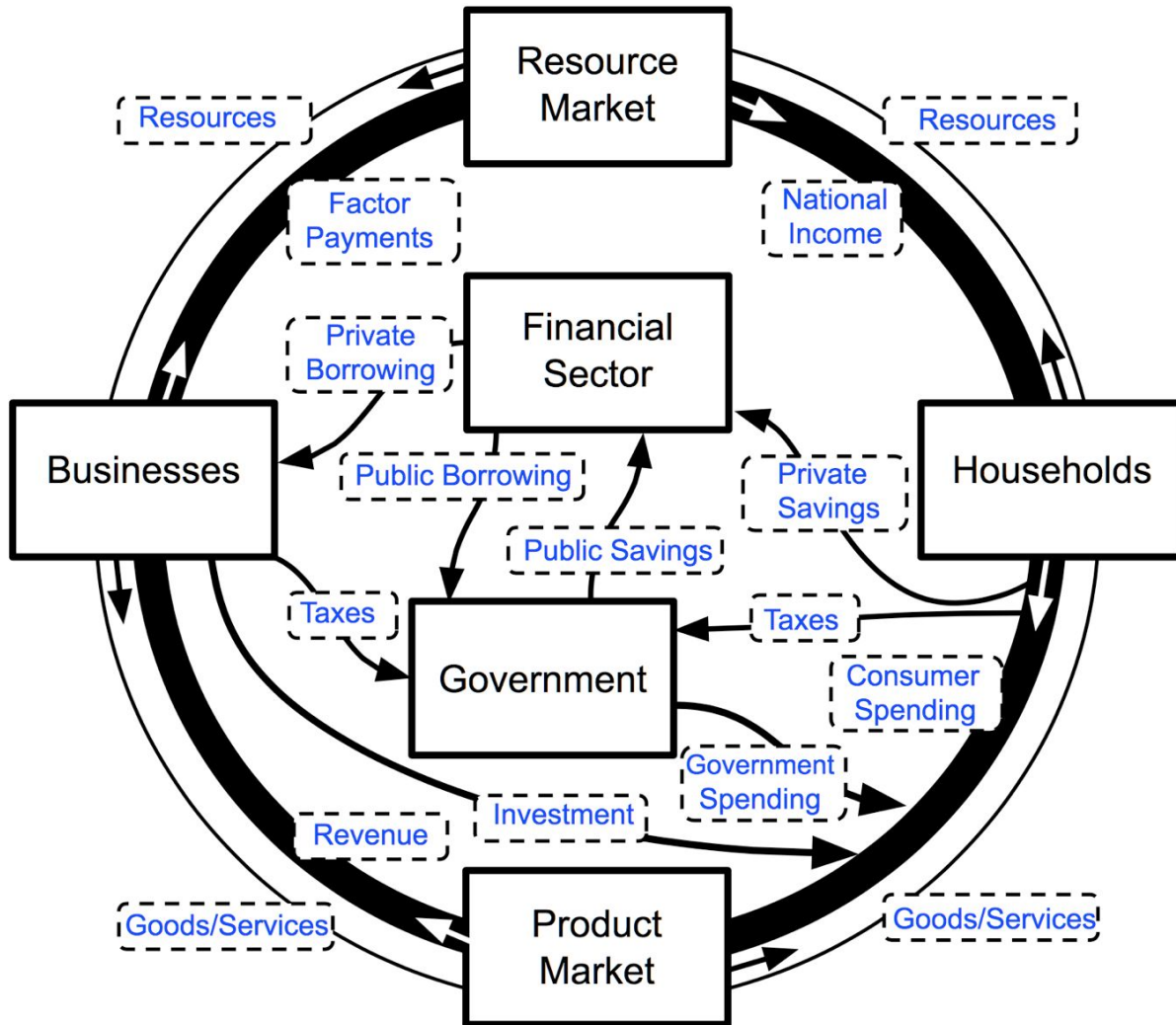
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1. What are the four components of GDP using the expenditure approach?
Consumer spending, business investment, government spending, and net exports
2. What are the four components of GDP using the income approach?
Wages, rent, interest, and profit (these are called factor payments)
3. Explain why both the expenditure approach and income approach yield the same value of GDP.
One person's spending is another person's income. If spending increases by \$100 then incomes increase by \$100
4. What are government transfer payments and why are they not included in the calculation of GDP?

Video Help: <https://youtu.be/BnrBRuoVefY>



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Transfer payments are when the government gives money to households or businesses (example: welfare). They are not included since doing so would result in double counting.

5. Why are financial transactions not included in the calculation of GDP?

Financial transactions, like the sale and purchase of bonds, are not counted since GDP only includes the production of new goods/services. Financial transactions don't count because nothing is produced

Part 2: Practice- Identify if each of the following is an example of consumer spending (C), investment spending (I), government spending (G), net exports (XN), or not counted in GDP (NC) for the USA.

6. C You purchase a pizza for \$10
7. I A pizza restaurant spends \$4000 on advertising
8. XN The government of Egypt buys 20 fighter jets from the US
9. NC The US government offers a \$1000 tax rebate for purchasing a fuel efficient car
10. C A college student pay \$15,000 for tuition
11. G The US postal service builds a new building in Washington DC
12. NC Harley-Davidson builds 200 motorcycles in Mexico and sells them to people in Europe
13. NC Your friend helps you move into a new apartment
14. I Your family builds a new home in Wisconsin for \$450,000
15. XN An American retail company spends \$3 million on Chinese toys

Part 3: Put It All Together- The table below lists the costs and prices for four businesses involved in making, distributing, and selling a ton of tomatoes. Use the information to answer the questions below.

	Cost of Inputs	Price of Output
Farmer Fred	\$0	\$150
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16. Calculate the GDP using value-added approach. Explain how you got your answer.

GDP= \$450. Add up the difference between the costs for each business and the price at each step of the production process. $\$150 + \$100 + \$150 + \$50 = \$450$.

17. How much is the GDP using the expenditure approach? How is this process for calculating GDP different than the value-added approach?

GDP = \$450. The expenditure approach is based on the value of *final* goods and the tomatoes are sold as a final good to consumers for \$450.