

UNIT 2 – SUPPLEMENT 1a:
NATIONAL INCOME ACCOUNTING (NIA): WHERE DID IT COME FROM, WHAT DOES IT DO?

One of the basic problems in macroeconomics is that many of the things we are interested in are difficult to measure; in some cases just because collecting the data is difficult and time consuming. However, there are some cases where it is even difficult to figure out what we ought to measure! The best example of this latter point is the measurement of “quantities” using National Income Accounting (NIA).

When economists look at an economy, they often picture it as a series of markets that are intertwined. Within each market, there is a selling price and there is a quantity bought and sold. Economists focus on prices and quantities. In macroeconomics, we are interested in the “big picture.” Thus, we are interested in the average price level across all of these individual markets as well as the total quantity of goods and services being bought and sold.

However, there is a serious problem with measuring the total quantity of goods produced: how do we add together the quantity of autos sold, the quantity of doctor’s visits sold, the quantity of movie tickets sold, the number of apples sold, plus a few hundred thousand other goods and services? For example, if our economy produces and sells 1 million autos and 20 million apples, does it make sense to add them together and to say that we produced 21 million “things?” Of course not. What we need is a single unit of measurement for quantity that applies equally well to all of these diverse goods and services. Surprisingly, the only way to do this involves using prices to measure quantities.

In a market economy, most products and services have a market price. Thus, instead of measuring everything in its own unique way, we can measure quantities in terms of their market values. So, what did we produce and sell last year? \$500 million of autos, \$100 million of doctor’s visits, \$80 million of movie tickets, \$10 million of apples sold, and so on. What does this add up to? \$690 million worth of “things.” Does that make sense? Yes.

This simple and clever idea was adopted by governments and economists about 80 years ago. A system was created, the “National Income Accounting (NIA)” system, to standardize the way that these numbers would be measured. Unfortunately, as with many good ideas, when you start to implement all the details, you discover that it is not so easy to apply it to many of the “complexities” in the real world. However, it is the best and only system that we have, so we must decide how to handle a wide-range of real world complexities.

How much does the U.S. produce in a year? In 2010, the U.S. economy produced about \$14.66 trillion (or \$14,660 billion) of goods and services. That number is written out as \$14,660,000,000,000.00