Understanding Business: What's Not Included in the GDP

Important, but Often Forgotten Information About our Gross Domestic Product

By **John Galt**

While there are many important factors for business, understanding the overall level of the economy is virtually priceless knowledge. In turn, one of the most important factors to a nations economy, and thus, all business and career related functions found within, is the Gross Domestic Product (GDP). The GDP is, essentially, a way to measure the market value of the goods and serviced produced by a nation during the current fiscal year. However, while the GDP is very important, too few understand precisely how its works, and one the most misunderstood factors is what actually contributes to the GDP and what does not.

Takeaways

- What is the GDP?
- Why are certain factors not included?
- What are those factors?

Understanding the items which are excluded from the GDP is crucial for understanding the overall value of the economy, as only certain goods and services actually apply.

The first, and generally largest category of excluded goods are what are known as "intermediate goods". In short, intermediate goods are those goods which are purchased solely for their use in producing another product. For example, let us say that a coal mining company produces fifty dollars worth of metal ore. This fifty dollars produced by the company is added to the countries GDP. Now, that fifty dollars worth of ore is sold to a steel company, which uses the ore to produce two hundred dollars worth of steel. Because fifty dollars of the two hundred was already counted, the amount added to the GDP by the steel company is only one hundred and fifty dollars. Now, let us take this one step further and assume that the two hundreds dollars worth of steel is sold to a car company, which produces and sells a car for one thousand dollars. Because two hundred dollars of steel was already produced and accounted for, the value added to the GDP by the sale of that vehicle will only be eight hundred dollars. Thus, if we add up the three numbers together, we find that 1150 dollars were produced total for the three companies, but that only 1000 dollars is actually added to the value of the GDP. If we were to add intermediate goods to the GPA, we would be double and triple counting a lot of values, so this system helps to make sure that the GDP remains accurate.

Another important category of excluded items are what are known as "non-market activities". For example, let us say that a stay at home mom or dad has an estimated worth to their household of $25,000. However, because these do not contribute to the overall GDP, and no money changes hands, the value of the mother or father is not counted towards the total GDP. On the other hand, if we pay someone to clean our house or baby sit our children, that value is added to the GDP, as it is not a non market activity.

When we think of the GDP, we may also think that some values should lower it, such as pollution or environmental damage. However, this is not the case. Even if a company does roughly $20,000 dollars worth of environmental damage per year, that amount is not subtracted from the GDP.

Another category known as "transfer payments" are also not included into the overall value of the GDP. Transfer payments include payments which are made but for which nothing is done in response. In government terms, this equates to payments such as social security or unemployment. In private sector terms, transfer payments comprise charity donations and the like. Because this money is "transferred" and not used to pay for anything or get anything in return, it is not considered as part of the GDP. Likewise, financial transactions, such as fluctuation in the value of bonds and stocks is not counted towards the total GDP.

It may seem to be common sense, but income or money related to illegal activities is also not counted. Also excluded is the sales from used items, as those have already been counted as a part of the GDP during their initial sale period.

Although the world of the GDP and the world economy can sometimes seem a bit difficult, it is incredibly important that we are aware of our economy, it is virtually impossible to be successful in any form of business without some type of background knowledge with regards to the economy and how it functions. Although the GDP is a massive issue, we can take a step towards knowing and understanding it by realizing what goods do and do not count towards the total value of the GDP, it is a basic lesson in economics that we can carry with us effectively for the rest of our lives.

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