SECTION 6.2 THE EXPENDITURE APPROACH TO MEASURING GDP

- Using the **expenditure approach,** GDP is calculated by adding up the expenditures of market participants on final goods and services over a period of time.
- For convenience and analytical purposes, economists usually categorize expenditures into four categories: consumption C; investment, I; government purchases, G; and net exports (which equals exports (X) minus imports (M), or $X - M$).
- Following the expenditure method, GDP = $C + I + G + (X - M)$.
- **Consumption** refers to the purchase of consumer goods and services by households. It does not include purchases by business or government. More than half of GDP in a given year goes for consumer goods and services (about 57% in 2003).

Exhibit 1: *2010 Canadian GDP by Type of Spending*

- Consumption spending is usually broken down into three subcategories; nondurable goods, durable consumer goods, and services.
- **Nondurable goods** include tangible consumer items that are typically consumed or used up in a relatively short period of time. **Durable goods** include longer-lived consumer goods, the most important single category of which is consumer vehicles. On occasion, it is difficult to decide whether a good is durable or nondurable, and the definitions are, therefore, somewhat arbitrary.
- The distinction between durables and nondurables is important because consumer buying behavior is somewhat different for each of these categories of goods. In boom periods, when GDP is rising rapidly, expenditures on durables often increase dramatically, while in years of stagnant or falling GDP, sales of durable goods often plummet. By contrast, sales of nondurables tend to be more stable over time because purchases of such goods are more difficult to shift from one time period to another.
- **Services** are intangible items of value, as opposed to physical goods. Service expenditures have been growing faster than spending on goods; the share of total consumption going for services is now over 50 per cent.
- **Investment** refers to the creation of capital goods whose purpose is to produce other goods. This definition of investment deviates from the popular use of that term - purchases of company shares are not an investment as defined by economists.
- There are two categories of investment purchases measured in the expenditures approach: fixed investment and inventory investment.
- **Fixed investments**, sometimes called **producer goods**, include all spending on capital goods, such as machinery, tools, and factory buildings, which increase our future production capabilities, as well as residential construction.
- **Inventory investment** includes all purchases by businesses that add to their inventories—stocks of goods kept on hand by businesses to meet customer demands.
- In recent years, investment expenditures have generally been around 20 percent of gross domestic product. Investment spending is the most volatile category of GDP, however, and tends to fluctuate considerably with changing business conditions. When the economy is

booming, investment purchases tend to increase dramatically. In downturns, the reverse happens.

- Government purchases of goods and services are included in GDP. However, transfer payments (e.g. Employment Insurance and Canada Pension Plan payments) are not included because that spending does not go to purchase newly produced goods or services. The government purchase proportion of GDP, currently 22 per cent of GDP, has grown rapidly over the last 50 years in part due to rising spending of publicly funded health care.

- Some of the goods and services that are produced in the Canada are exported for use in other countries. These goods and services were made in Canada and therefore are included in a measure of Canadian production. However, some of our expenditures in other categories were for foreign-produced goods and services. These imports must be excluded from GDP in order to obtain an accurate measure of Canadian production. Thus, GDP calculations measure **net exports**, total exports (X) minus total imports (M). In 2010, Canada/s net exports were $31 billion, or 2 per cent of GDP.
- Overall, trade is an important part of the Canadian economy. In 2010, exports were $478 billion or 29 per cent of GDP. Imports were $509 billion (31 per cent of GDP). Canada is a very open economy, highly dependent on foreign markets for both buying and selling goods and services.

Business Connection *- Does the GDP Have to be an Exact Measurement?*