AN INTRODUCTION TO GNP/GDP

Before you read about the causes of the Great Depression, a brief introduction to a few economics concepts will be helpful.

"The economy" is not an abstraction; it is something that can be counted quite precisely in dollars (or whatever monetary unit a country uses). When economists refer to the economy, they refer to a statistic known as "Gross National Product" (GNP) or today, "Gross Domestic Product" (GDP). For our purposes, the differences between GNP and GDP are not important. Instead, focus on what they measure. GDP and GNP are defined as:

1. The market value of all final goods and services produced in a country in a year.
2. Final goods and services have been purchased for final use. They are not for resale or further manufacture.

Economists measure GNP/GDP by adding up the money spent on four major categories of goods and services in the economy:

- **Consumption (C):** Spending by households on final goods and services. Includes spending on things such as cars, food, and visits to the dentist.
- **Investment (I):** Spending by businesses on machinery, factories, equipment, tools and construction of new buildings. BUYING STOCKS AND BONDS DOES NOT COUNT AS INVESTMENT WITHIN THE FRAMEWORK OF GDP/GNP. These transactions are included in an alternative measure of the economy known as Gross Domestic Income.
- **Government (G):** Spending by all levels of government (national, state and local) on goods and services. Includes spending on the military, schools, and highways.
- **Net Exports (X - M):** Spending by people abroad on U.S. goods and services (exports, or X) minus spending by people in the U.S. on foreign goods and services (imports, or M).

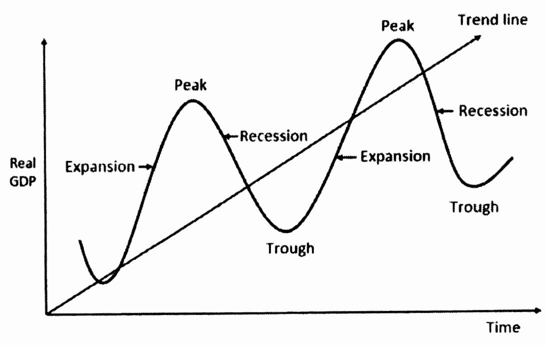
An Example:

In 2016, in trillions of U.S. dollars, second quarter GDP estimates were:

GDP	=	C	+	I	+	G	+	X	-	M
$18.45	=	12.69	+	2.98	+	3.26	+	2.20	-	2.70

Source: Section 1: "Domestic Product and Income," Table 1.1.5 :Gross Domestic Product; http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1

The long-term trend of the economy is to grow (i.e. GNP/GDP goes up). However, there are periods of time where the economy shrinks. When GNP/GDP declines for six consecutive months, prices fall, the number of jobless workers increases and the economy is said to be in a **recession**. A major recession (i.e. a big decline in GNP) is called a **depression.** These ups and downs of the economy are reflected in a graph known as the "business cycle." In the graph below, the economy grows during the expansion to the Peak and shrinks from the Peak to the Trough. Note that the overall trend is toward growth.



As you read the article, think about how changes to the various components of GNP during the 1920s—Consumption, Investment, Government spending, Exports and Imports—contributed to the Great Depression.

The Stock Market Crash of 1929

The 1929 stock market crash is better thought of as an effect of the economy's problems, rather than a cause. Nonetheless, there were buying and selling practices taking place in the 1920s that made the crash much worse than it needed to be. Those practices are discussed below.

Key Terms

a. Stock – Buying partial ownership in a company. You receive stock certificates to indicate how much money you have invested.
b. Bull Market – When the market is going up. Origin of the term: A bull kills its victim by throwing it up in the air.
c. Bear Market – When the market is going down. Origin of the term: A bear kills its victim by stamping it on the ground.
d. Buying on Margin – Buying stock on credit
e. Margin Requirement – Percentage of cash that you must put down when you buy stock on margin. For example, if the margin requirement is 10% and you want to purchase $1,000 worth of stock you must put down $100 in cash. A stockbroker puts down the remaining 90% (in this case, $900).
f. Margin Call – A call from one's broker indicating that the price of a stock purchased on margin has dropped so low that you will have to sell immediately or put up more cash.
g. Dividends - Money that the company pays you if it makes money (profit). The amount that you receive depends on the number of shares of stock that you own.
h. Capital Gains Tax – Money that you must pay to the government when you sell your stock for a higher price than you paid for it.
i. Insider Trading – Occurs when someone buys or sells a stock based on information that only someone who worked for the company would know. This practice is illegal.

—Stocks and the Economy—

Complete these sentences by using the following word bank. Use each term once, except words with an (*), which should be used twice.

down, company, jobs, spend, economy dividends, products, growing, ownership, stock, *profits, strong, weak, earn, unemployed, *products

Remember that a share of (1) _______ represents partial (2)________________of a company. Every owner, no matter how small his or her share is, is entitled to a portion of the (3) ____________'s (4)________. Over time, the main reason why stock prices go up or (5) _____ depends on the profits investors expect a company to (6)_______. These profits, which are paid to investors/owners in the form of (7)___________, are influenced by the well being of the larger (8)_______________. If the economy is (9) ____________, more people have (10)_______ and money to (11)_________on a company's (12)_____________. If the economy is (13) ________, more people are (14)_______________, and do not have the money to buy a company's products, which lowers the company's (15)______________, since they cannot sell as many (16)_________.

Buying and Selling on Margin: How it Works

1. You think that because of the iPod, Apple will be profitable for years to come. Therefore, you purchase 100 shares of stock in Apple Computer for $50 per share. How much must you pay?

   ____

2. The price of Apple's stock reaches $75 per share, because people love the new iPod that can play videos. You decide to sell. How much money will you receive? $______.

3. How much profit will you make?______________________

4. In this example, assume that many companies besides Apple are experiencing rising share prices. Did you buy and sell during a bear market or a bull market?

5. Suppose Microsoft makes a cheaper version of the video iPod. Apple Computer stock—which you paid $50 per share for—falls to $25 per share. You decide to cut your losses and sell. How much money will you receive? __________________How much is your loss?_______________.

6. Using the information from "5", did you buy your stock during a bull market or bear market?

Buying Stock on Margin

7. You are going to buy stock on margin. The margin requirement is 10%. You want to buy $50,000 worth of Apple Computer stock. How much cash must you provide?________ How much cash must your broker provide?_________

8. If Apple stock sells for $50 per share and you buy $50,000 worth of stock, how many shares have you bought?_______

9. Apple stock reaches $75 per share and you sell. How much money will you receive?_____

10. What is your profit?______ Why did people buy on margin?

11. Instead of going up, Apple stock begins to drop. When the stock reaches $25 per share, you receive a margin call from your broker. You are forced to sell the stock. How much do you receive from the sale of the stock at this price? _____________ Compared with the original sales price, how much money have you lost?______________.

12. Today, why are margin requirements higher than 10%?