

International Comparisons

by Sophia Tutorial



WHAT'S COVERED

This tutorial will cover international comparisons, comparing GDP and GNP as measures for economic growth in a country.

Our discussion breaks down as follows:

1. GDP vs. GNP
 - a. Significance of the Difference
2. GDP vs. GNP: International Comparisons
3. GDP and Measuring Quality of Life

1. GDP vs. GNP

We know that GDP growth from one period to the next is an indication of a healthy macroeconomy. However, GDP and GNP can also be used to help us compare growth from one nation to another, making international comparisons.



BIG IDEA

Both GDP and GNP attempt to measure all economic activity of a country in a year.

Both GDP and GNP measure the final value of all goods and services in an economy, so in this respect, they are very similar. The only difference is how "in an economy" is defined.

GDP, since it is gross domestic product, focuses on domestic production. It is concerned with where that production is occurring, or the location of the production. GDP represents everything produced in a country's borders. It does not matter *who* is doing the producing, or *who* owns the capital producing it.

GNP, or gross national product, on the other hand, focuses on production by nationals. It is concerned with who is doing the producing. GNP represents everything produced by a nation's people, and it does not matter where the producing is occurring.

Therefore, you can see that the phrase "in an economy" depends on whether it is concerned with who is doing the producing, or where the producing is occurring.

➡ **EXAMPLE** When Hershey, which is an American company, produces chocolate in factories located in Mexico, the value of this chocolate counts for Mexico GDP, because it is occurring in Mexico. However, it counts for United States GNP, because it is occurring by an American-owned company.

Using another example, when Honda cars are manufactured in Ohio, this counts for the United States GDP because the production is occurring here in one of our states, but it counts for Japan GNP, because Honda is owned by Japan.



TERMS TO KNOW

GDP

Gross Domestic Product; the sum value of goods and services produced within a country's borders

GNP

Gross National Product; the sum value of goods and services produced by a country's nationals regardless of location

1a. Significance of the Difference

Now, the difference between GDP and GNP is not significant for countries who have both domestic production and foreign production by their companies, and who have other, foreign nations producing domestically to offset their own nation's production elsewhere.

Notice in the previous examples, we had production occurring outside of our country offset by another country producing here, so the difference between GDP and GNP was not significant.

However, there are countries where there is a significant difference.

GDP will actually be less than GNP in countries who have a lot of production by their residents occurring in other nations. like Hershey in Mexico, but they do not have other foreign nations producing domestically to offset that production elsewhere (like Honda producing in Ohio, domestically).

In this case, GDP may not be a good indication of the actual health or strength of an economy.

Now, the opposite can also occur, where GDP can be greater than GNP.

This occurs in countries who have a lot of other nations producing domestically, known as foreign direct investment, but they do not have a lot of their own companies producing overseas.

In these cases, GDP may be overstated, as much of the profits are leaving the country in the form of foreign direct investment. Therefore, GDP is not a great indicator of economic strength.

2. GDP vs. GNP: International Comparisons

Despite some of these issues, GDP is still widely used today as a standard way of comparing economies internationally.

As we would expect, developed countries enjoy much greater GDP growth than developing or less developed countries.

In developed, strong economies, we find that when there is a lot of foreign investment domestically, the domestic economy still tends to benefit, as citizens in those strong countries have the wealth and income to consume the goods and services being produced.

3. GDP and Measuring Quality of Life

Although real GDP, as mentioned, is used to compare quality of life between countries, or standard of living, is it really a perfect measure of all economic activity or how people live in a country?

No, not necessarily.

First of all, real GDP does not measure any non-market activities, referring to those activities that people do for themselves, such as:

- Cleaning our own homes
- Caring for children
- Changing the oil on our own car

There is no way to measure those kinds of activities; they are non-market.

In addition, GDP does not completely measure the quality of life or well-being of a population.

➦ **EXAMPLE** For example, the economy might be "growing" according to GDP, but perhaps it is because everyone is working much longer hours and sacrificing leisure time. This, then, is not necessarily measuring quality of life. We might have more stuff, but are people really better off? It also doesn't measure things like pollution emitted from all this production, or crime, etc.

Finally, it is important to note that when we measure GDP per person, called GDP per capita, we need to understand that it is an average.

So, if GDP per capita rises, we can certainly say that our standard of living has improved, but this is an average. Does it mean that everyone is better off?

It could simply mean that income disparity is growing. Perhaps all of the gains to our GDP per capita have actually been realized by the most wealthy, and not by the middle class or lower classes, which is very important to keep in mind.

BIG IDEA

The bottom line is that although it is not perfect for comparing *quality of life*, GDP does indicate and provide a way to compare *consumption* across nations.

SUMMARY

Today we compared **GDP vs. GNP**, learning that both can be used to measure economic growth in a nation, and that there can be varying **significance of the difference between GDP and GNP**. We learned that with **international comparisons**, there can be differences between these two measures,

because GDP focuses on where the production is occurring (i.e., domestic production), while GNP is concerned with production by a nation's residents. Lastly, we discussed a few of the shortcomings of GDP as a **measure of quality of life**.

Source: Adapted from Sophia instructor Kate Eskra.



TERMS TO KNOW

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GNP

Gross National Product; the sum value of goods and services produces by a country's nationals regardless of location.