12-2-2020

The Economy, the Stock Market, and a Bucket of Chicken

Tim Meyer

University of Nebraska-Lincoln

AGRICULTURAL ECONOMICS

December 2, 2020

agecon.unl.edu/cornhuskereconomics

Cornhusker Economics

The Economy, the Stock Market, and a Bucket of Chicken

Economists, unlike MDs and lawyers, are never able to sidestep professional questions. Whether it is at parties, or waiting to pick up kids from school, the "economy" is almost as common as the weather for small talk. Fortunately, most economists are eager to opine on the current state of affairs, and almost as many are willing to guide laypeople to a truer understanding of what the "economy" actually is. This article will provide a definition of the economy, the Gross Domestic Product (GDP), and their importance. It will conclude by addressing the difference between the overall economy and the performance of specific markets.

A Definition

The size of the economy, and therefore the economy's performance, can best be described as "A big pile o' stuff." If the pile is growing, the economy is doing well. If the pile is shrinking, the economy is doing poorly. "A big pile o' stuff" is not going to win any research awards, so this definition needs to be better articulated. This "big pile o' stuff" is what is referred to as GDP. Defining GDP is important, but of equal importance is understanding how it is measured.

The Expenditure Approach

Most economists agree that the best way to measure an economy's performance is by GDP. The Bureau of Economic Analysis is in charge of measuring GDP. GDP is typically measured each year or quarter. Any new good (or service) produced during that time period is included. Changes to inventories are included as well, to offer a consistent comparison from one year to the next. The "D" in GDP stands for domestic and simply means produced within the United States. There are two common ways to measure GDP, and in my experience teaching introductory level classes, the expenditure approach is the easiest to digest.

Take a box of donuts. Twelve circles of joy most certainly belong in our pile, and the more donuts are produced, the better is our standard of living. GDP's measurement can be determined by simply adding together the amount of money spent by four groups: consumers (C), businesses (I), the government (G), and the rest of the world (X). Donuts purchased by consumers for personal use, a business for a meeting, a government agency, or Canadians all count the same way. A donut is a donut, no matter who is eating it. If donuts do not illustrate the expenditure approach, imagine a white Ford pickup truck. Each entity buys trucks, and the purchase reflects an addition to GDP in exactly the same way.

It should be noted the actual expenditure approach, GDP=C+I+G+X-M subtracts imports. That's because the donuts we buy may have Canadian Maple topping and subtracting all our imports (M) adjusts for this fact.

The expenditure approach motivates understanding for students because they understand the consumer side of economics. The more stuff we buy, the better off (happier?) we are. This makes sense, students have ample buying experience. What many of them are lacking is work experience, which is likely why the next approach is more challenging.

The Income Approach

GDP has another definition, national income, that states everything produced represents income to someone. To better understand, think about the income statement for one single bucket of chicken. For argument's sake, assume the bucket of chicken (two breasts, thighs, wings and legs) sells for $10. When the bucket of chicken is sold, GDP rises by $10, as does income.

Consider the simplified income statement (or profit and loss statement) below:

Income Statement
One Bucket of Chicken

Revenue	
Chicken	***$10.00***
Expenses	
COGS (Variable Costs)	
Raw Chicken	$1.50
Oil	$0.50
The Bucket	$0.25
Spices	$2.00
Wages	$2.00
Total	***$6.25***
Overhead (Fixed Costs)	
Rent	$0.50
Insurance	$0.50
Depreciation	$0.50
Total	***$1.50***
Total Expenses	***$7.75***
Profit (before taxes)	***$2.25***

The income statement's main purpose is to show the profit the restaurant makes ($2.25), but it can also be used to illustrate that the expenses represent income to different parties. In this case it is estimated that an employee is paid approximately $2/bucket (probably divided between several employees). This is clearly income. Additionally, perhaps the chicken is sold at a franchised restaurant, whereby proprietary spice packets are used. In this case, $2 is paid to some sort of honorary southern Colonel, which is also income. Likewise, the bucket, oil, and raw chicken all represent income to someone else.

When GDP rises, there is more chicken, donuts and pickup trucks. It means we consume more, have more jobs (less unemployment), and more income. In this regard, GDP is a direct reflection of the standard of living in a country. Conversely GDP has some shortfalls. It measures the cost of a security system (not something we *want)* the same way it measures fried chicken. It has no way of calculating the benefits of at-home production. It also does not account for income inequality, or fairness within the economic system. Nonetheless, it is universally the starting place for macroeconomic measurement.

What the "Economy" is NOT

Unfortunately, many casual conversations about the economy are about specific markets. When the stock market goes up, only people owning stock benefit, and many of those people do not realize any explicit benefit as most of their stock holdings are in retirement accounts. During the last eight months of the pandemic, the stock market has almost completely recovered, while GDP and unemployment have not. All of us feel changes in GDP, while very few are benefitted (or harmed) by a changing stock market.

In Nebraska, we have the "farm economy" which is just an informal nod to the fact that our state's GDP is weighted heavily towards agricultural products. While farmers and ranchers are subjected to the risks associated with commodity prices, input prices, and volatile interest rates, they are somewhat insulated from macroeconomic fluctuations of GDP. After all, we all need to eat.

This does not imply there has been no hardship during the COVID-19 pandemic. Stories of euthanized livestock and other economic hardships are real. The crowding out of small farms and rural communities by corporations is a larger issue to address as well. Thankfully, the skill, know-how, and resilience of Nebraska ag producers has and will allow us to weather downturns in the "economy" now, and hopefully for many years to come.

Tim Meyer
Associate Prof. of Practice
Department of Agricultural Economics
University of Nebraska
tmeyer19@unl.edu