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(Paper-2)

Expenditure Method

What Is the Expenditure Method?

The expenditure method is a system for calculating gross domestic product (GDP) that combines consumption, investment, government spending, and net exports. It is the most common way to estimate GDP. It says everything that the private sector, including consumers and private firms, and government spend within the borders of a particular country, must add up to the total value of all finished goods and services produced over a certain period of time. This method produces nominal GDP, which must then be adjusted for inflation to result in the real GDP.

The expenditure method may be contrasted with the income approach for calculated GDP.

KEY TAKEAWAYS

- The expenditure method is the most common way of calculating a country's GDP.

- This method adds up consumer spending, investment, government expenditure, and net exports.
- Aggregate demand is equivalent to the expenditure equation for GDP in the long-run.
- The alternative method to calculate GDP is the income approach.

How the Expenditure Method Works

Expenditure is a reference to spending. In economics, another term for consumer spending is demand. The total spending, or demand, in the economy is known as aggregate demand. This is why the GDP formula is actually the same as the formula for calculating aggregate demand. Because of this, aggregate demand and expenditure GDP must fall or rise in tandem.

However, this similarity isn't technically always present in the real world—especially when looking at GDP over the long run. Short-run aggregate demand only measures total output for a single nominal price level, or the average of current prices across the entire spectrum of goods and services produced in the economy. Aggregate demand only equals GDP in the long run after adjusting for price level.