

Exercise walk-through

2.2

Limitations of GDP

AP Macroeconomics

What GDP misses

Nonmarket : home cooking, volunteering – unpaid, so uncounted

Underground : hidden work escapes the figures

Externalities : pollution lowers well-being, not GDP

GDP measures **output**, not well-being – it ignores leisure and the **distribution of income**.

To compare living standards, use real **GDP per capita**

$$= \frac{\text{real GDP}}{\text{population}}.$$

A huge total can still hide a low average.

What the measures leave out

Does recorded GDP capture the activity?

Parent provides unpaid childcare	Not included; no market transaction.
Parent pays a childcare provider	Market service included.
Unreported cash work	Can escape recorded output.
Factory output rises with pollution	GDP can rise while well-being falls.

GDP measures output. Distribution and environmental damage prevent a simple inference about welfare; there is no universal direction of welfare bias.

Exercises 2.1-2.3

2.1 State two things that GDP fails to measure.

[2]

2.2 State why GDP per capita is better than total GDP for comparing living standards.[1]

2.3 Explain why the underground economy causes GDP to understate output.

[2]

Exercises 2.1-2.3

2.1 State two things that GDP fails to measure. [2]

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- any two of: nonmarket production, the underground economy, externalities/pollution, leisure, income distribution

2.2 State why GDP per capita is better than total GDP for comparing living standards.[1]

2.2

- it adjusts for population, so it reflects output **per person** rather than the size of the country

2.3 Explain why the underground economy causes GDP to understate output. [2]

2.3

- its activity is unreported, so that output is missing from the official GDP figure

Exercises 3.1-3.2

3.1 GDP does **not** include

[1]

☐

- A restaurant meals
- B unpaid housework
- C newly built houses
- D exports

3.2 To compare living standards across countries, economists prefer

[1]

☐

- A total GDP
- B GDP per capita
- C nominal GDP
- D the CPI

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- unpaid housework.

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3.2 B

- GDP per capita.

Exercise 3.3 (a)

3.3 A country has a high GDP but severe pollution and very unequal incomes.

(a) State two limitations of GDP that this illustrates.

[2]

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(a)

- it ignores externalities/pollution and the distribution of income

Exercise 3.3 (b)

3.3 A country has a high GDP but severe pollution and very unequal incomes.

(b) Name a per-person measure that better reflects average living standards. [1]

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(b)

- GDP per capita