

2.2 Limitations of GDP

Name: _____ Class: _____ Date: _____ **Total: 10 marks**

KEY WORDS gdp per capita • underground economy • externalities
• nonmarket transactions • nominal gdp

Objective

Build the skills to answer exam questions on **the limitations of GDP**.

You must be able to:

- explain why GDP omits **nonmarket transactions**
- describe how the **underground economy** causes GDP to understate output
- explain why GDP ignores **externalities**, resource depletion, and income distribution
- explain why **GDP per capita** GDP is better for comparing living standards

1 Key knowledge and worked examples

Study these first. Each one shows the method for a question type used later.

■ What GDP leaves out

- **Nonmarket** work: housework, volunteering, DIY.
- The **underground economy**: unreported and illegal activity (so GDP understates output).
- **Externalities** and resource depletion: pollution and using up nature are ignored.
- **Leisure** and the **distribution** of income: two countries with equal GDP can differ hugely in well-being.

■ GDP per capita

Dividing by population gives **GDP per capita**, a far better guide to average living standards than total GDP.

2 Practice

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]

3 Exam-style questions

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

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]

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