

Exercise walk-through

Limitations of GDP ■ 2.2

eXercise

You must be able to

- explain why GDP omits **nonmarket transactions** 非市场交易
- describe how the **underground economy** 地下经济 causes GDP to understate output
- explain why GDP ignores **externalities** 外部性, resource depletion, and income distribution
- explain why **GDP per capita** 人均 GDP is better for comparing living standards

Method — 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.

Method — GDP per capita

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

Practice 2.1 ■ 2 marks

State two things that GDP fails to measure.

Solution 2.1

Worked steps

any two of: nonmarket production, the underground economy, externalities/pollution, leisure, income distribution **B1** **B1**.

Practice 2.2 ■ 1 mark

State why GDP per capita is better than total GDP for comparing living standards.

Solution 2.2

Method: GDP per capita

Worked steps

it adjusts for population, so it reflects output **per person** rather than the size of the country **B1**.

Practice 2.3 ■ 2 marks

Explain why the underground economy causes GDP to understate output.

Solution 2.3

Method: What GDP leaves out

Worked steps

its activity is unreported **B1**, so that output is missing from the official GDP figure **B1**.

Exam-style 3.1 ■ 1 mark

GDP does **not** include

A restaurant meals

B unpaid housework

C newly built houses

D exports

Solution 3.1

A restaurant meals

B unpaid housework



C newly built houses

D exports

Worked steps

B.

Exam-style 3.2 ■ 1 mark

To compare living standards across countries, economists prefer

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

Solution 3.2

Method: GDP per capita

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

Worked steps

B.

Exam-style 3.3 ■ 2 marks

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

- (a) State two limitations of GDP that this illustrates.
- (b) Name a per-person measure that better reflects average living standards.

Solution 3.3

Method: GDP per capita

Worked steps

(a) it ignores externalities/pollution and the distribution of income **B1** **B1**. (b) GDP per capita **B1**.