Exercise walk-through

3.1
Output measures, spending and the multiplier

Pearson Edexcel · International A-Level · Economics

Measures of economic performance (8)

- **seasonal** : ski instructors in summer;
- **structural** : workers' skills no longer match the jobs available. When China restructured its state-owned enterprises in the late 1990s, tens of millions of workers were laid off, many in the old industrial north-east;
- **demand-deficient** : too little total spending, as in a **recession**;
- **real-wage inflexibility**: wages stuck above the level that clears the labour market.

Aggregate demand

- **Consumption** (C) depends on disposable income, interest rates, confidence, **wealth** and credit. The **savings ratio** is saving as a share of disposable income; Chinese households save about a third.
- **Investment** (I) is spending on capital goods; **net investment** is gross investment minus depreciation. It depends on growth, interest rates, business confidence, credit and corporation tax.
- **Government spending** (G) depends on fiscal policy, the state of the economy and political priorities.
- **Net exports** (X − M) depend on income at home, the exchange rate, growth abroad, protectionism and quality.

$$AD = C + I + G + (X - M)$$

Economic growth

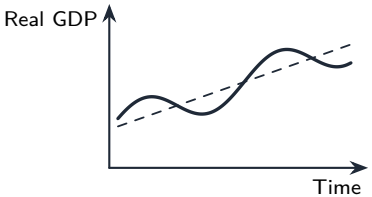
- **Actual growth** in the short run comes from any part of AD: **consumption**, **investment**, government spending or net exports. **Export-led growth** adds demand from abroad; China's exports grew from about 4% of world exports in 2001, when it joined the WTO, to about 13% by 2015.
- Potential growth comes from investment (domestic and **foreign direct investment**), innovation, a growing labour force and stronger competition. In the long run, **productivity** — output per worker — matters most. South Korea's GDP per head rose from about the same as Ghana's in 1960 to a high-income level by the 1990s, largely through investment in education and machinery.
- opportunity cost: investing more means consuming less today;

Exercises 2.1·2.2

2.1 Nominal GDP index is 112, the price deflator 108 and the population index 102. Calculate real GDP and real GDP per capita. [3]

nominal GDP index: 112
price deflator: 108
population index: 102

2.2 Define a recession and state how it differs from one quarter of negative growth. [2]



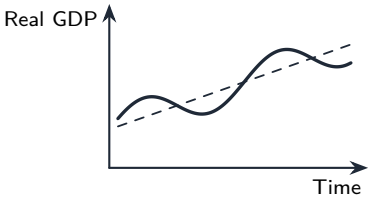
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price deflator: 108
population index: 102

2.1 Real GDP $= \frac{112}{108} \times 100 = 103.7$; per capita $= \frac{103.7}{102} \times 100 = 101.7$.

2.2 Define a recession and state how it differs from one quarter of negative growth. [2]



2.2 A recession is two consecutive quarters of negative real GDP growth; one negative quarter alone is not a recession by the standard definition.

Exercises 2.3·2.4

2.3 A CPI basket has three goods with weights 50, 30 and 20. Their prices this year are 110%, 100% and 120% of last year's. Calculate the CPI and the inflation rate. [3]

food: weight 50, relative 110

housing: weight 30, relative 100

transport: weight 20, relative 120

2.4 *(SAM WEC12/01 Q12(b), adapted.)* India's inflation fell from about 12% in 2010 to about 9% in 2011. Was this deflation? Explain. [2]

2010: about 12%

2011: about 9%

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food: weight 50, relative 110

housing: weight 30, relative 100

transport: weight 20, relative 120

2.3 CPI $= 0.5 \times 110 + 0.3 \times 100 + 0.2 \times 120 = 55 + 30 + 24 = 109$; inflation $= 9\%$.

2.4 *(SAM WEC12/01 Q12(b), adapted.)* India's inflation fell from about 12% in 2010 to about 9% in 2011. Was this deflation? Explain. [2]

2010: about 12%

2011: about 9%

2.4 No – prices still ROSE, by 9% instead of 12%. The RATE of increase fell, which is disinflation; deflation would need a negative inflation rate.

Exercises 2.5·2.6

2.5 State the ILO definition of unemployment. [2]



2.6 Give two reasons why higher GDP per capita may not mean better living standards. [2]



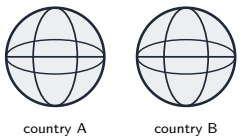
Exercises 2.5·2.6

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2.5 People without work who are available to start and have actively sought work in a recent reference period.

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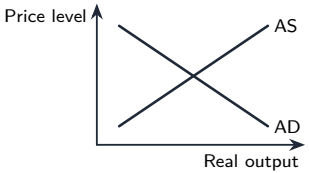
2.6 Any two: income distribution may widen; non-market and shadow-economy activity is missed; environmental damage is not deducted; working hours or health may worsen; prices differ across countries.

Exercises 2.7·3.1

2.7 Name the three components of the current account of the balance of payments. [2]



3.1 *(Original.)* Using an AD/AS diagram, distinguish demand-pull from cost-push inflation. [4]



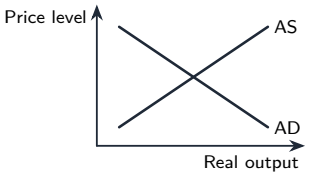
Exercises 2.7·3.1

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2.7 Trade in goods and services; primary income; secondary income.

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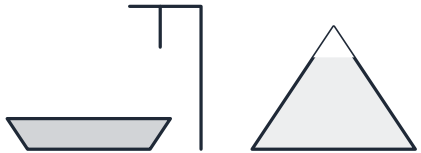


3.1 Demand-pull: the AD curve shifts RIGHT along a given SRAS – the price level rises because spending runs ahead of capacity (diagram: AD → AD2, price level up, output up). Cost-push: SRAS shifts LEFT along a given AD – input costs (wages, oil) raise prices at every output (diagram: SRAS → SRAS2, price level up, output DOWN). The output direction separates them: both raise prices, only demand-pull raises output.

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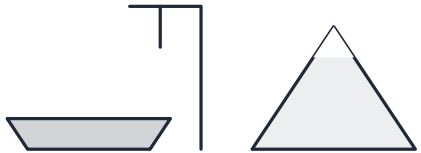
Exercise 3.2

3.2 *(Original.)* Classify each as frictional, seasonal, structural, demand-deficiency or real-wage unemployment: (a) a shipyard closes and its workers lack other local skills; (b) a ski instructor in July; (c) spending falls in a recession; (d) a new graduate looking for a first job. [4]



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3.2 (a) Structural. (b) Seasonal. (c) Demand-deficiency. (d) Frictional. (Real-wage unemployment would be wages fixed above the market-clearing level.)

Exercise 3.3

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3.3 Market exchange rates reflect currency markets, not purchasing power: the same basket costs far less in some countries than its exchange-rate price suggests. PPP rates equalise basket prices, so converting at PPP compares REAL volumes rather than distorted price levels.

Local review guidance: index calculations show the divide before the answer; the disinflation/deflation verdict quotes the sign of the rate; classifications use the spec's five names, not paraphrases; diagram marks require labelled axes, both curves and the shift arrow. This is authored classroom guidance.