Exercise walk-through

3.4
Economic growth (2.3.5)

Pearson Edexcel · International A-Level · Economics

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

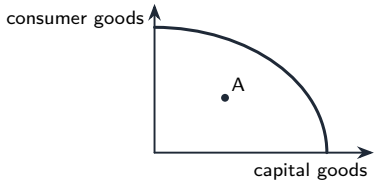
- **Actual growth** in the short run comes from any part of AD: **consumption**, **investment**, government spending or net exports. **Export-led growth** adds demand from abroad; China's exports grew from about 4% of world exports in 2001, when it joined the WTO, to about 13% by 2015.
- Potential growth 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;

Data-response practice (Section B style)

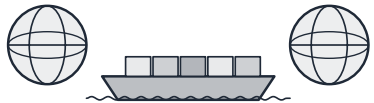
- (a) Ireland's **nominal GDP** rose from €200 billion to €262 billion in a year in which the GDP deflator rose from 100 to 104. Calculate the rate of **real GDP** growth. [3]
- (b) Explain the difference between GDP and GNI. [3]
- (c) Using the extract, explain why GDP per head may overstate living standards in Ireland. [6]

Exercises 2.1·2.2

2.1 Distinguish actual growth from potential growth. [2]

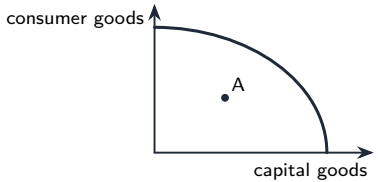


2.2 Why can export-led growth raise output with less inflationary pressure than a consumer boom? [2]



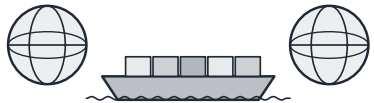
Exercises 2.1·2.2

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2.1 Actual growth is a rise in real output using existing capacity (a movement towards the PPF); potential growth is a rise in capacity itself (an outward shift of the PPF).

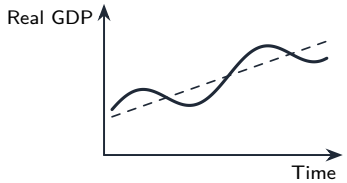
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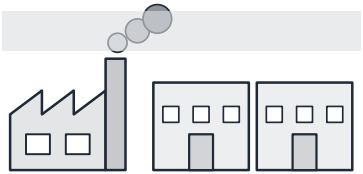
2.2 Exports add demand from abroad, so domestic spending does not run ahead of domestic supply in the same way; the growth arrives without the excess demand that fuels demand-pull inflation – and trade gains can offset import-led overheating.

Exercises 2.3·2.4

2.3 State any two benefits of economic growth. [2]

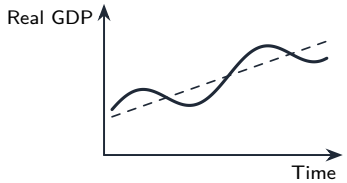


2.4 State any two costs of economic growth. [2]



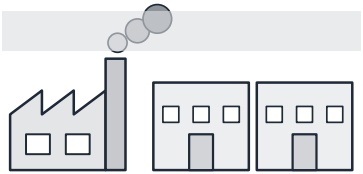
Exercises 2.3·2.4

2.3 State any two benefits of economic growth. [2]



2.3 Any two: higher living standards; lower unemployment; higher profits; higher investment; increased tax revenues; improved public services.

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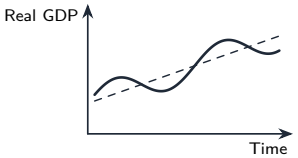


2.4 Any two: opportunity costs (investment instead of current consumption); environmental costs; trade deficits; increased inequality; inflation.

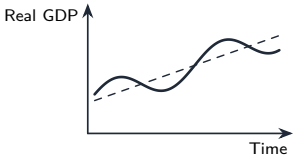
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Exercises 2.5·3.1

2.5 Distinguish a positive from a negative output gap. [2]

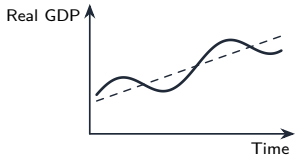


3.1 *(Original.)* The economy moves from a negative to a positive output gap. Analyse the effects on inflation and unemployment. [4]



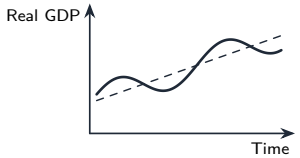
Exercises 2.5·3.1

2.5 Distinguish a positive from a negative output gap. [2]



2.5 A positive gap: actual output ABOVE trend (inflationary pressure). A negative gap: actual output BELOW trend (spare capacity, unemployment).

3.1 *(Original.)* The economy moves from a negative to a positive output gap. Analyse the effects on inflation and unemployment. [4]



3.1 Crossing from below trend to above it, spare capacity is used up: firms bid for scarce labour and materials, so wage and price pressures build – demand-pull inflation rises – while unemployment falls below its structural floor. Once the gap is positive, further demand raises prices faster than output (the classical vertical LRAS binds).

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Exercise 3.2

3.2 *(Original.)* Explain how foreign direct investment and productivity growth each raise POTENTIAL growth. [4]



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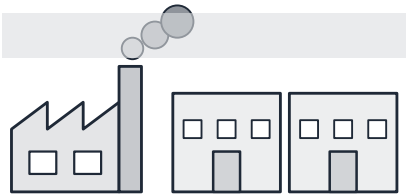
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3.2 FDI adds to the capital stock directly (new plants and equipment) and often brings technology and management practice with it – capacity rises, so LRAS shifts right. Productivity growth means more output per unit of input, so the SAME factors produce more – the deepest source of potential growth and the reason long-run growth rates differ across countries.

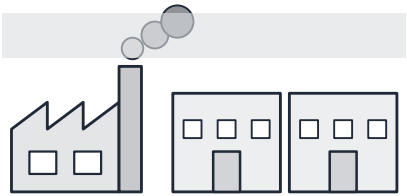
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3.3 *(Original.)* "Rapid growth is worth any environmental cost." Comment, giving one argument each way. [4]



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3.3 For: growth funds the tax revenue and technology that pay for environmental protection, and lifts people out of poverty – the costs of NOT growing include unemployment and poor public services. Against: environmental damage (emissions, resource depletion) is an external cost the market price of growth omits, and some damage is irreversible, so "any cost" overstates the case. A reasoned verdict weighing opportunity cost earns the evaluation mark.

Local review guidance: gap answers connect the gap's SIGN to the inflation/unemployment mechanism; benefits/costs from the specification lists; (R1 3.3) a two-sided argument with a stated verdict, not one side only. This is authored classroom guidance.