

Exercise walk-through

3.4

Economic growth (2.3.5)

Pearson Edexcel · International A-Level · Economics

1. Topic 3 at a glance

Topic 3 at a glance

WEC12 macro first half: spec sections 2.3.1 to 2.3.5 in full - measures of economic performance (four rows), aggregate demand (five rows), aggregate supply (three rows), national income (four rows) and economic growth (four rows), 66 objectives.

Must-know: real GDP = nominal divided by deflator times 100; per capita divides by population; CPI = weighted sum of price relatives; $AD = C + I + G + (X - M)$; multiplier $k = 1/(1-MPC) = 1/MPW$ with $MPW = MPS + MPT + MPM$; SAM anchor $k = 2$ turning a 30 billion injection into 60.

2. Measures of economic performance

Measures of economic performance

Real versus nominal, total versus per capita, value versus volume; GNI adds net income from abroad; PPP rates equalise basket prices for fair comparisons; recession = two consecutive negative quarters; GDP misses distribution, the shadow economy and the environment, so wellbeing indicators complement it. Nominal 112 with deflator 108 gives real 103.7; over population 102, per capita 101.7.

Inflation: $CPI = 0.5 \times 110 + 0.3 \times 100 + 0.2 \times 120 = 109$, so 9 percent; disinflation means a slower RISE (the SAM India chart: 12 to 9, 11 to 6 - never negative); causes are demand-pull, cost-push and money-supply growth. Unemployment by the ILO definition with five causes; underemployment is distinct; the current account trades goods, services and income.

6. Economic growth

Economic growth

Actual growth moves towards the PPF; potential growth shifts it out, driven by investment and FDI, innovation, labour-force growth including migration, competition and above all productivity. Benefits: living standards, employment, profits, investment, tax revenue, public services.

Costs: opportunity cost, environment, trade deficits, inequality, inflation. An output gap is actual minus trend: positive gaps build inflationary pressure; negative gaps mean spare capacity - and both are hard to measure because the trend is estimated and data is revised.

Exercises 2.1·2.3

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]

2.3 State any two benefits of economic growth.

[2]

Exercises 2.1·2.3

2.1 Distinguish actual growth from potential growth. [2]

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).

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

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.

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.

Exercises 2.4·3.1

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

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 2.4·3.1

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

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

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).

Exercises 3.2·3.3

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

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

Exercises 3.2-3.3

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

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.

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

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.