3.4 Economic growth

Name: _____ Class: _____ Date: _____ **Total: 22 marks**

KEY WORDS inflation • deflation

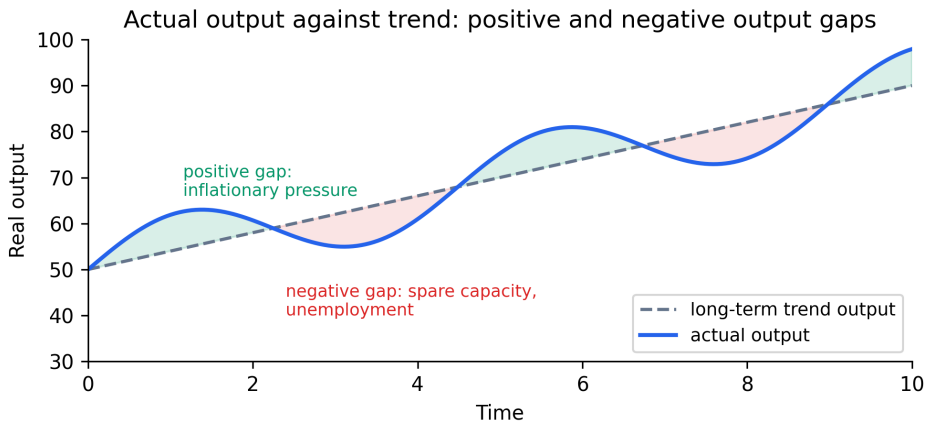
Economic growth

Objective

Distinguish actual from potential growth, explain causes, benefits and costs, and interpret output gaps (spec 2.3.5, rows 1–4).

1 Key knowledge and worked examples

Growth and gaps. Actual growth moves the economy towards its PPF; potential growth shifts the PPF out. 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 output: positive gaps build inflationary pressure, negative gaps mean spare capacity.



Original cycle; the shaded bands are the two gap types.

2 Practice

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]

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

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

3 Exam-style questions

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

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]

Solutions

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

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

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

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).

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 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.