

Output measures, spending and the multiplier

Edexcel IAL Economics WEC12 sections 2.3.1-2.3.5 full package with SAM anchors

1. Topic 3 at a glance

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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: $\text{CPI} = 0.5 \times 110 + 0.3 \times 100 + 0.2 \times 120 = 109$, 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.

3. Aggregate demand

Aggregate demand

$AD = C + I + G + (X - M)$; with 60, 20, 20 and 0, $AD = 100$. The price level moves **ALONG** the curve; any component change **SHIFTS** it. Consumption follows disposable income, interest rates, confidence, welfare, wealth and credit - the savings ratio is what is not spent.

Investment distinguishes gross from net and follows growth, interest rates, confidence, credit and corporation tax; government spending follows fiscal policy, activity, market failure and politics; net trade follows income, exchange rates, the world economy, protectionism and non-price factors.

4. Aggregate supply

Aggregate supply

SRAS shifts with raw material and energy costs, exchange rates and taxes. The long run comes in two shapes: Keynesian - flat with spare capacity, curving up to vertical at capacity - and classical - vertical at full employment, the economy tending back there.

LRAS shifts with technology, productivity, education and skills, regulation and tax, demography and migration, and competition policy. The shape chosen determines whether a demand shift mainly moves output (Keynesian short run) or prices (classical long run).

5. National income and the multiplier

National income and the multiplier

The circular flow: households supply factors, firms pay incomes, incomes buy output. Injections (I, G, X) add spending; withdrawals (S, T, M) drain it; equilibrium when $I + G + X = S + T + M$. In the model AD $P = 90 - Y/2$ meets SRAS $P = 20 + Y/2$ at (70, 55); an injection of 15 moves the economy to (85, 62.5).

The multiplier: $k = 1/(1-MPC) = 1/MPW$. The SAM anchor: MPC 0.5 gives $k = 2$, so 30 billion becomes 60 billion. With MPW 0.5 the same $k = 2$; with MPC 0.8, $k = 5$ and an injection of 20 accumulates 20, 16, 12.8... to 100. High import propensities drain the process abroad.

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.

Check yourself

Check yourself

GDP, GNI, PPP, recession, CPI and its limitations; unemployment causes and underemployment; the current account.

AD components and their influences; SRAS and LRAS shift factors with the two LRAS shapes.

Circular flow, injections and withdrawals, equilibrium, the multiplier formulae with the SAM and own examples.

Actual versus potential growth; benefits, costs and output gaps.