

Exercise walk-through

3.1

Output measures, spending and the multiplier

Pearson Edexcel · International A-Level · Economics

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The method

Method — Worked example

Nominal GDP includes price changes; real GDP adjusts them; per-capita GDP also accounts for population. GDP and GNI differ in their income boundary. Comparisons need consistent dates, definitions and purchasing-power treatment where applicable. AD includes $C+I+G+(X-M)$; real output response depends on aggregate supply and spare capacity.

An original economy's nominal GDP index rises from 100 to 112, its deflator from 100 to 108 and its population index from 100 to 102. Calculate real and real-per-capita changes.

Real GDP growth factor = nominal factor / price factor = $1.12/1.08 = 1.037037$. Real growth = $(1.037037 - 1) \times 100\% = 3.70\%$. Real-per-capita factor = real factor / population factor = $1.037037/1.02 = 1.016703$. Per-capita real growth = $(1.016703 - 1) \times 100\% = 1.67\%$. Dividing indices avoids treating an approximation as exact. Neither figure gives income distribution, unpaid output or environmental quality. For IAL's simple closed multiplier model, $k = 1/(1 - MPC)$; with

Method — Worked example

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Exercises 2.1·3.1

2.1 For the worked case, state the method, show its application and give a limitation.[3]

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3.1 An economy has spare capacity, but extra spending leaks into imports and saving. Explain the likely adjustment and why the simple multiplier can overpredict domestic output. [3]

3.1 An AD increase can raise domestic real output when supply can respond. Saving and imports reduce successive domestic spending rounds; tax leakages may also matter. Draw an appropriate AD/AS shift and label output and price level, qualifying the size of each response by spare capacity and bottlenecks. The simple closed model omits imports and taxes, so its k is not an unconditional domestic forecast. IGCSE work does not add the IAL multiplier as a mandatory extension. Authored points for judgement, case-linked reasoning and justified qualification. Accept supported alternatives.