CIE Economics A-level

Topic 4: The Macroeconomy

b) National income statistics

Notes

Use of National Income statistics as measures of economic growth and living standards

- Economic growth occurs when there is a rise in the value of Gross Domestic Product (GDP).
- GDP measures the quantity of goods and services produced in an economy. In other words, a rise in economic growth means there has been an increase in national output.
- Economic growth leads to higher living standards and more employment opportunities.
- **Real GDP** is the value of GDP adjusted for inflation. For example, if the economy grew by 4% since last year, but inflation was 2%, real economic growth was 2%.
- **Nominal GDP** is the value of GDP without being adjusted for inflation. In the above example, nominal economic growth is 4%. This is misleading, because it can make GDP appear higher than it really is.
- **Total GDP** is the combined monetary value of all goods and services produced within a country's borders during a specific time period.
- **GDP per capita** is the value of total GDP divided by the population of the country. Capita is another word for 'head', so it essentially measures the average output per person in an economy. This is useful for comparing the relative performance of countries.

- National income can also be measured by:

    - **Gross National Product (GNP)** is the market value of all products produced in an annum by the labour and property supplied by the citizens of one country. It includes GDP plus income earned from overseas assets minus income earned by overseas residents. GDP is within a country's borders, whilst GNP includes products produced by citizens of a country, whether inside the border or not.
    - **Gross National Income (GNI)** is the sum of value added by all producers who reside in a nation, plus product taxes (subtract subsidies) not included in the value of output, plus receipts of primary income from abroad (this is the compensation of employees and property income).

The use and limitations of national income data to compare differences in living standards between countries

- GDP does not give any indication of the distribution of income. Therefore, two countries with similar GDPs per capita may have different distributions which lead to different living standards in the country.
- GDP may need to be recalculated in terms of purchasing power, so that it can account for international price differences. The purchasing power is determined by the cost of living in each country, and the inflation rate.
- There are also large hidden economies, such as the black market, which are not accounted for in GDP. This can make GDP comparisons misleading and difficult to compare.
- GDP gives no indication of welfare. Other measures, such as the happiness index, might be used to compare living standards instead or in conjunction with GDP.

The importance of using purchasing power parity (PPP) exchange rates when making international comparisons of living standards

- This is a theory that estimates how much the exchange rate needs adjusting so that an exchange between countries is equivalent, according to each currency's purchasing power. For example, if a car cost £15,000 and the exchange rate between the UK and the US is 1.5 £ per $, then in the US, the car should cost $10,000. This means both cars cost the same number of US dollars, and the same number of pounds Sterling.
- This helps to minimise misleading comparisons between countries.

National debt (government or public sector debt)

- The **national debt** is the amount of money the government has borrowed at one time through issuing securities by the Treasury.

Factors influencing the size of national debts

- The national debt is the accumulation of the government deficit over time. It is the total amount the government owes.
- If the government is continuously running a deficit, the size of the debt increases.
- If the government reduces the size of their deficit, the rate of increase of the total debt is slower, but the debt is still increasing.
- It is only when the government runs a budget surplus that the size of the national debt decreases. Currently, the UK government is trying to reduce the size of the deficit and eventually run a budget surplus by 2019-2020, at which point they will start paying off the debt.

The significance of the size of national debts

- The cost of borrowing could increase, since by borrowing money, the government is increasing demand for credit in the economy.
- If confidence is lost in the government's ability to repay the debt, governments might have to raise interest rates to encourage investors to buy bonds, so that they can finance the debt.
- It could lead to higher taxes and austerity measures, especially if the debt becomes uncontrollable.
- A fiscal deficit could be inflationary if it increases AD.
- More government spending could lead to crowding out of the private sector. This leaves fewer funds in the private sector for firms to use, since the government is borrowing money, which crowds them out of the market.