



# eLearneconomics: Economic Growth – Different Measures (1)

## Student response \_\_\_\_\_

(a) Complete the statements below using the words provided.

|           |             |             |        |
|-----------|-------------|-------------|--------|
| base year | expenditure | population  | time   |
| better    | final       | prices      | volume |
| calculate | income      | price index |        |
| current   | inflation   | production  |        |
| deflated  | money       | real        |        |
| economy   | output      | sum         |        |

- (i) GDP is the \_\_\_\_\_ of the money values of all final goods and services produced in an \_\_\_\_\_ over a specific period of \_\_\_\_\_.
- (ii) There are different ways to \_\_\_\_\_ GDP, by looking at the economy in slightly different ways. The \_\_\_\_\_ method measures the final value of all incomes generated in production. The \_\_\_\_\_ approach uses the value added at each stage of production. GDP can also be calculated using the \_\_\_\_\_ approach, which is the sum of the market value of purchases of all \_\_\_\_\_ goods and services produced in the economy.
- (iii) Nominal GDP calculates production in \_\_\_\_\_ year prices. Real GDP is nominal GDP adjusted for \_\_\_\_\_ so is a \_\_\_\_\_ measure of \_\_\_\_\_ production ( \_\_\_\_\_ ) in the economy.
- (iv) Changes in nominal GDP will generally be in part due to changes in the \_\_\_\_\_ of output of goods and services, and in part to changes in \_\_\_\_\_ (inflation).
- (v) To remove the price component from a measure of GDP expressed in nominal (or \_\_\_\_\_) terms, nominal GDP can be \_\_\_\_\_ by means of a \_\_\_\_\_, thus providing GDP in constant dollars, that is, GDP measured in prices applying in the \_\_\_\_\_ of the price index used.
- (vi) Dividing real GDP by the country's \_\_\_\_\_ provides real GDP per capita.
- (b) (i) Use the information below, calculate how much the GDP has increased or decreased in real terms. Show your working.

|                         | 2000   | 2005   |
|-------------------------|--------|--------|
| Nominal GDP             | \$400m | \$600m |
| CPI                     | 1 000  | 1 200  |
| Real GDP in 2000 prices |        |        |

- (ii) State and explain the main conclusion you can draw from your answers to (i) above.
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_



## Solutions

(a) Complete the statements below using the words provided.

|           |             |             |        |
|-----------|-------------|-------------|--------|
| base year | expenditure | population  | time   |
| better    | final       | prices      | volume |
| calculate | income      | price index |        |
| current   | inflation   | production  |        |
| deflated  | money       | real        |        |
| economy   | output      | sum         |        |

- (i) GDP is the sum of the money values of all final goods and services produced in an economy over a specific period of time.
- (ii) There are different ways to calculate GDP, by looking at the economy in slightly different ways. The income method measures the final value of all incomes generated in production. The production approach uses the value added at each stage of production. GDP can also be calculated using the expenditure approach, which is the sum of the market value of purchases of all final goods and services produced in the economy.
- (iii) Nominal GDP calculates production in current year prices. Real GDP is nominal GDP adjusted for inflation so is a better measure of real production (output) in the economy.
- (iv) Changes in nominal GDP will generally be in part due to changes in the volume of output of goods and services, and in part to changes in prices (inflation).
- (v) To remove the price component from a measure of GDP expressed in nominal (or money) terms, nominal GDP can be deflated by means of a price index, thus providing GDP in constant dollars, that is, GDP measured in prices applying in the base year of the price index used.
- (vi) Dividing real GDP by the country's population provides real GDP per capita.
- (b) (i) Use the information below, calculate how much the GDP has increased or decreased in real terms. Show your working.

|                         | 2000          | 2005          |
|-------------------------|---------------|---------------|
| Nominal GDP             | \$400m        | \$600m        |
| CPI                     | 1 000         | 1 200         |
| Real GDP in 2000 prices | <u>\$400m</u> | <u>\$500m</u> |

$$\frac{600}{1200} \times 1\,000 = 500\text{m} \text{ therefore real GDP has increased by \$100m or 25\% in real terms.}$$

- (ii) State and explain the main conclusion you can draw from your answers to (i) above.

The percentage change in nominal GDP is greater than the percentage change in real GDP, the difference is due to inflation.



# eLearneconomics: Economic Growth – Different Measures (2)

**Student response** \_\_\_\_\_

**(a)** Match the phrase in the table to the most appropriate measure of economic growth (real income or productive capacity or net social welfare).

| Phrase                                                                                                        | Measure of growth |
|---------------------------------------------------------------------------------------------------------------|-------------------|
| (i) Refers to actual economic output, that is, the total number of goods and services produced by an economy. |                   |
| (ii) Refers to the maximum output an economy could produce.                                                   |                   |
| (iii) Often used to determine which nation has a better quality of life.                                      |                   |
| (iv) Contains information on economic factors and non-economic factors.                                       |                   |
| (v) Measures economic potential, rather than looking at actual output of an economy.                          |                   |

**(b)** Explain why real GDP is a better measure of a country's economic well-being than nominal GDP.

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**(c)** Why might net social welfare be considered a better definition of growth than real income?

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## Solutions

(a) Match the phrase in the table to the most appropriate measure of economic growth (real income or productive capacity or net social welfare).

| Phrase                                                                                                        | Measure of growth   |
|---------------------------------------------------------------------------------------------------------------|---------------------|
| (i) Refers to actual economic output, that is, the total number of goods and services produced by an economy. | Real income         |
| (ii) Refers to the maximum output an economy could produce.                                                   | Productive capacity |
| (iii) Often used to determine which nation has a better quality of life.                                      | Net social welfare  |
| (iv) Contains information on economic factors and non-economic factors.                                       | Net social welfare  |
| (v) Measures economic potential, rather than looking at actual output of an economy.                          | Productive capacity |

(b) Explain why real GDP is a better measure of a country's economic well-being than nominal GDP.

Real GDP takes into account changes in the price level (inflation), therefore it measures changes in real output (output comment critical to show well-being).

(c) Why might net social welfare be considered a better definition of growth than real income?

Real income shows that more goods have been produced whereas net social welfare takes into account non-economic costs, e.g., congestion and pollution, as well as economic aspects.