FURTHER limitations of using GDP to compare living standards between countries and over time

- Difficulty knowing whether to use the official value of the currency (exchange rates) or the purchasing power of that country.
- Size of the public sector does government expenditure improve living standards or hinder them? For example, in the UK the public sector comprises 50% of the economy, whereas in many developing countries this figure is lower than 20%.
- Quality issues e.g. spending on schools could be high, but few children are attending.
- Also: see notes above in regard to subsistence economy and income distribution.
- **Real values** = values have been adjusted to remove the effects of inflation.
- **Nominal values** = the current income you would see if figures were unadjusted.
- Also, when looking at economic growth we should look at values rather than volumes (e.g. Germany = greatest exporter by value, China = greatest exporter by volume).
- Total vs. per capita = per capita is divided by the population.

Other national income measures (do not need to leave definitions, you can just use the abbreviated definition at the and O

- **GNP** = GDP + income that residents have received from abroad income claimed by non-residents.
- **GNL CUP** Choome paid in **O** the country by other countries for such things as interest and dividentis.
- Both GNP and GNI measure output from the citizens and companies of a particular country, regardless of whether they are located within its boundaries or overseas.
- **GNI/GNP** = the value of everything produced by that country's factors of production, no matter where they are located.

Purchasing Power Parity (PPP) = the exchange rate needed to be able to buy the exact same basket of goods and services in another country.

So this is when values are expressed in accordance with the amount that the currency will buy in the local economy.

E.g. In the UK, a basket of goods costs me £1,000.
I want to buy the exact same basket in the USA.
The real exchange rate is £1 = \$1.60.
BUT the basket of goods costs me \$1,700 in the USA.

- "Full employment".
- But we want unemployment to be above 0% because when full employment is reached (according to the Keynesian and Classical AS curves), if AD increases then the economy cannot produce any more output. Therefore the only effect is inflation.

Impacts on employment

- The school leaving age (currently 18 this makes the workforce smaller but, in the long term, will likely make school leavers more employable).
- Number of school leavers entering higher/further education.
- Level of net migration (the difference between immigration and emigration).
 - → Immigration can cause employment AND unemployment to rise at the same time, as the size of the workforce increases, but migrants may struggle to get jobs if they have poor English/limited qualifications.
- Availability of jobs.
- Level of taxes and benefits if income taxes or out-of-work benefits are high, then there is a disincentive for people to work.

Causes and types of unemployment

 Real wage unemployment (Classical unemployment) = a measure of people who are unwilling to work at the going wage rate, so there is an excess supply of labour. Occurs when a minimum wage is det above the equilibrium wage rate. In this view, unemployment S short-term and we should take a laissez-faire approach - we should cut unemployment benefits, curtail trade unions and abolist the minimum wage.



• Demand-deficient unemployment (Keynesian/cyclical unemployment) = this is involuntary unemployment due to a lack of demand for goods and services (e.g. "labour-shedding" when firms are affected by recession/slowdown phase). Most likely to occur when there is a negative competitiveness) or may subdue demand in the domestic market. This may lead to higher unemployment, but could also prevent the onset of inflation.

2.2 Aggregate demand (AD)

2.2.1 The characteristics of AD

Aggregate demand = the total planned expenditure (spending) on goods and services produced in the UK.

- AD = Consumption + Investment + government spending (G T) + trade (X-M).
- Consumption = 63% of AD, Investment = 16% of AD, Government spending = 19% of AD.
- There are three reasons why the AD curve is downwards sloping = savings (if saving increases, then consumption and investment decrease), low price level (net exports and consumption increase) and total spending (always roughly the same because people have the same amount of money to spend).
- The area underneath the AD curve is the same for any price level and real GDP. This is called the **real balance effect**.



2.2.2 Consumption (60% of AD)

Influences on consumption include:

- **Real disposable income** (e.g. if income tax is cut or there is an increase in tax free allowances this leads to higher disposable income and AD shifts). (*Disposable income = income remaining after the deduction of taxes, which is available to be spent or saved as one wishes*).
- Interest rates (lower rates = more spending because the cost of borrowing is less). Big impact on mortgages.

- Better supply chains.
- Efficiency of capital assets*.
- Demographic changes or migration.
- Increased healthcare spending.

Labour market*if it's to do with replacing workers with technology.Product market*if it's to do with producing more/better stuff.

- Classical economists believe that in the long run an economy will operate at full capacity, so there will be no unemployed resources.
- **Keynesian LRAS** is determined by the same factors as Classical LRAS. However, the shape is different because Keynes believed that the equilibrium level of output CAN occur below the full employment level of output.
- Keynes thought this because "in the long run, we are all dead".

Keynesian LRAS



The flat part of the graph (A) is elastic, the curve upwards (B) is called the bottleneck and the vertical hart (S) is called the inelastic hart.

A-moving towards full employment (Yfe) but there is still spare capacity due to unemployed resources. Price level (PL) remains unchanged. An increase in the components of AD leads to a movement towards Yfe.

B - starting to get some labour shortages. This leads to PL increasing due to the higher pressure on wages (trying to attract people who aren't working).

C - full employment has been reached. To attract workers from other firms, firms HAVE to increase wages, so PL increases. This provides financial incentives. If inactive people started to work, then the whole curve would shift outwards (new Yfe). HOWEVER this model is flawed because it only looks at wages as an incentive to work.

2.4 National income

2.4.1 National income

CIRCULAR FLOW OF INCOMES (the movement of spending in economy,



- This is a stock concept, meaning that wealth doesn't have a direct impact on the circular flow of income. However, changes in wealth have an effect on incomes and spending.
- This is called the **wealth effect** = the effect on incomes or spending when asset values change.
- **Income** = a flow concept. Money received from work or investments.

2.4.2 Injections and withdrawals

- **Injections** = flows into the circular flow of income comprising I, G and X.
- **Injections** = investment (I an increase in the capital stock), government spending (G) and exports (X).
- Withdrawals = flows out of the circular flow of income which comprise savings, tax and imports.
- Withdrawals are sometimes called leakages.
- These 3 withdrawals effectively determine the size of the multiplier.
- If injections = leakages, the economy is in equilibrium.
- If injections are greater than leakages, the economy will grow.