

MACROECONOMICS -

**Economic growth & Measurement of
economic growth**

By Kru P'Da and Kru P'Eve Knockout.Economics

Overviews

1. Definition of economic growth
2. GDP and limitation of measuring GDP
3. Measurement of economic growth



1. Definition of economic growth

Economic growth :

- ➡ An increase in national income and output or an increase in GDP
- ➡ An increase in productive potential of an economy over the period of time.



2. GDP and limitation of measuring GDP

Gross Domestic Product (GDP) : the total value of output produced in a country in a year

The difficulty of measuring GDP :

1. There are unrecorded activities

- Illegal activities
- Tax avoidance

2. Non marketed goods and services

- Voluntary activities
- Subsistence agriculture : agricultural goods for farmers' personal use



3. Measurement of economic growth

1. **Gross Domestic Product (GDP)** : the total value of output produced in a country in a year
2. **Nominal GDP** : Money GDP or GDP at current price. It is not adjusted for inflation
3. **Real GDP** : GDP at constant price or adjusted for inflation

$$\text{Real GDP}_{2019} = \text{Nominal GDP}_{2019} \times \frac{\text{Price index}_{\text{base year}}(100)}{\text{Price index}_{2019}}$$

4. **Real GDP per head** : Real GDP divided by population

$$\text{Real GDP per head}_{2019} = \frac{\text{Real GDP}_{2019}}{\text{Population}_{2019}}$$

5. **Economic growth** : The percentage change in GDP on a year earlier

$$\text{GDP Growth}_{2019} = \frac{\text{GDP}_{2019} - \text{GDP}_{2018}}{\text{GDP}_{2018}} \times 100$$

3. Measurement of economic growth

Exam What is the change in GDP per head, after adjusting inflation(real change), between 2018 and 2019? (Base year = 2018)

Year	Population (million)	Consumer Price Index (CPI)	GDP (million)
2018	2	100	2000
2019	2.5	110	2500

$$\text{Real GDP}_{2019} = \text{Nominal GDP}_{2019} \times \frac{\text{Price index base year}(100)}{\text{Price index}_{2019}}$$

$$\text{Real GDP per head}_{2019} = \frac{\text{Real GDP}_{2019}}{\text{Population}_{2019}}$$

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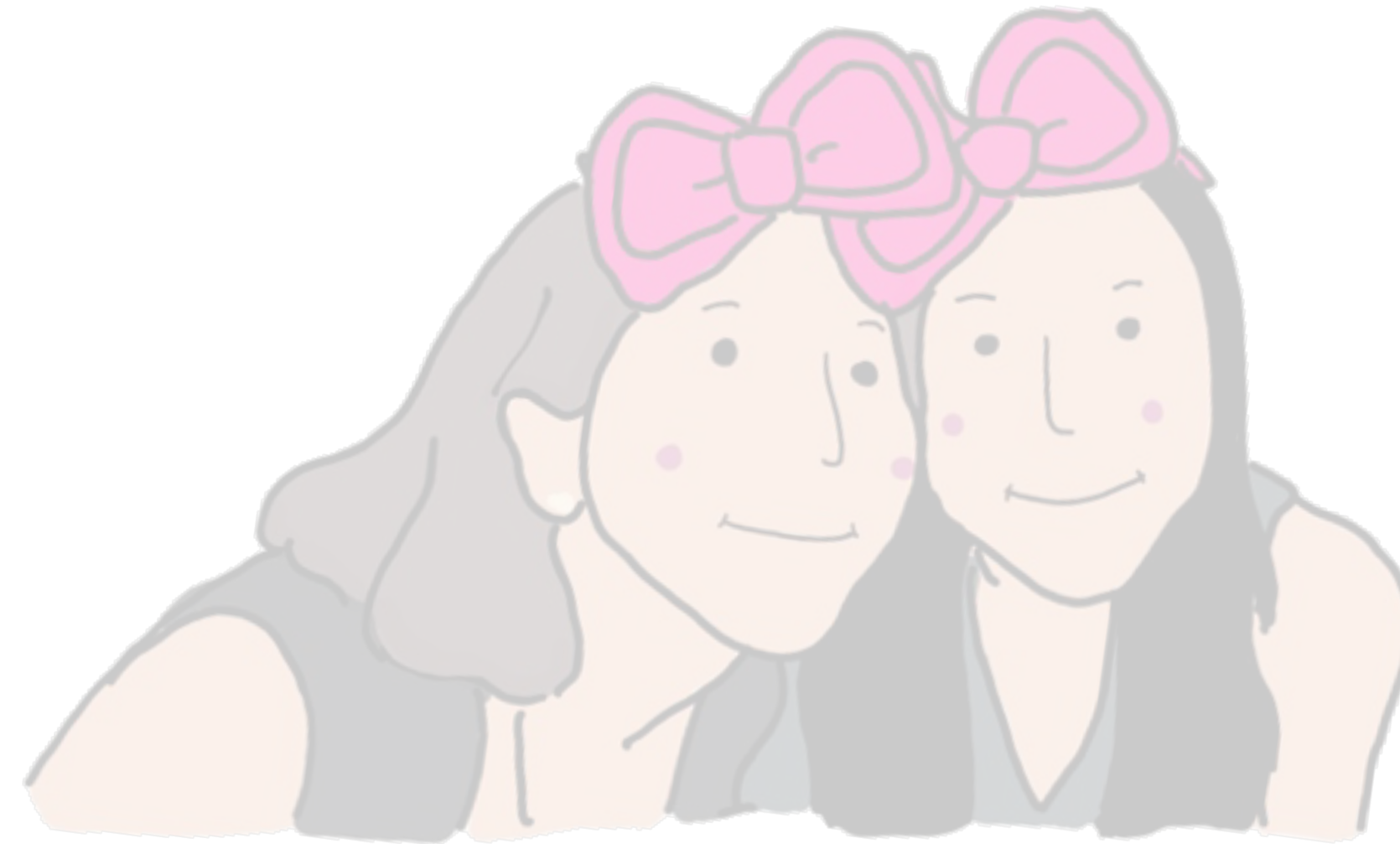
$$\text{Real GDP}_{2019} = \text{Nominal GDP}_{2019} \times \frac{\text{Price index base year}(100)}{\text{Price index}_{2019}}$$

$$\text{Real GDP per head}_{2019} = \frac{\text{Real GDP}_{2019}}{\text{Population}_{2019}}$$

- Real GDP 2018 = Nominal GDP 2018
- Real GDP per head 2018 = $\frac{\text{Real GDP 2018}}{\text{Population 2018}}$
- Real GDP 2019 = Nominal GDP₂₀₁₉ x $\frac{\text{Price index base year}(100)}{\text{Price index}_{2019}}$
- Real GDP per head 2019 = $\frac{\text{Real GDP 2019}}{\text{Population}_{2019}}$
- **Changes in Real GDP per head from 2018 to 2019**

3. Measurement of economic growth

Exam Economic growth fall from 8% in 2017 to 2.5% in 2018. How did GDP level changes from 2017 to 2018?



Hint : The economic growth

Positive growth means a rise in level of GDP

Negative growth means a fall in level of GDP

$$\text{GDP Growth}_{2018} = \frac{\text{GDP}_{2018} - \text{GDP}_{\text{base year}}}{\text{GDP}_{\text{base year}}} \times 100$$

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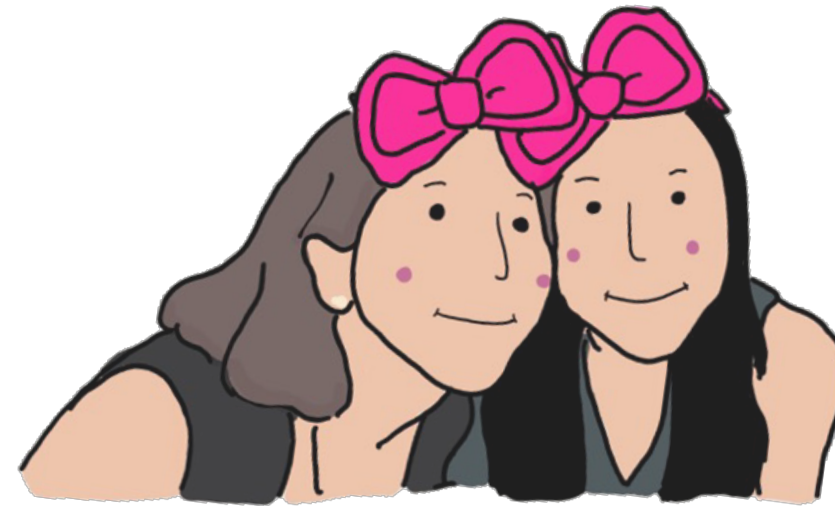
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MACROECONOMICS -

Causes and consequences of economic growth and recession & Policies to promote economic growth

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Overviews

1. Causes and consequences of recession
2. Causes and consequences of economic growth
3. Policies to promote economic growth



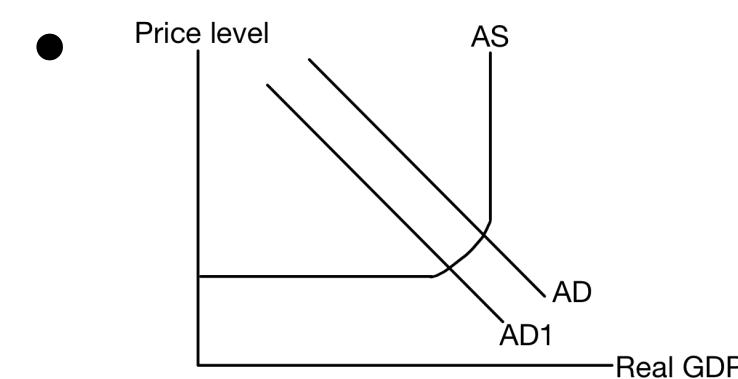
1. Causes and consequences of recession

Recession : A negative economic growth or a fall in GDP for 2 or more consecutive quarters.

Causes of recession

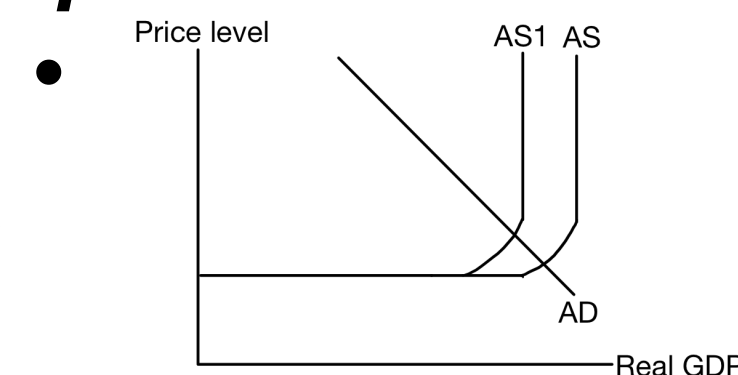
1. A decrease in aggregate demand(AD)

- e.g. **consumption decreases** due to the lack of consumer confidence.



2. A decrease in aggregate supply(AS)

- **A rise in cost** of production such as rising in price of oil and raw material. Firms **reduce production** as they gain lesser profit.



Consequences of recession

1. **Lower national output.**
2. **A rise in unemployment.**
3. **Lower living standard** from a fall in income and output.
4. Due to high unemployment during recession, it may cause **government budget deficit** from lower tax revenue and higher spending on unemployed benefits.
5. **A fall in price level** due to a decrease in AD.

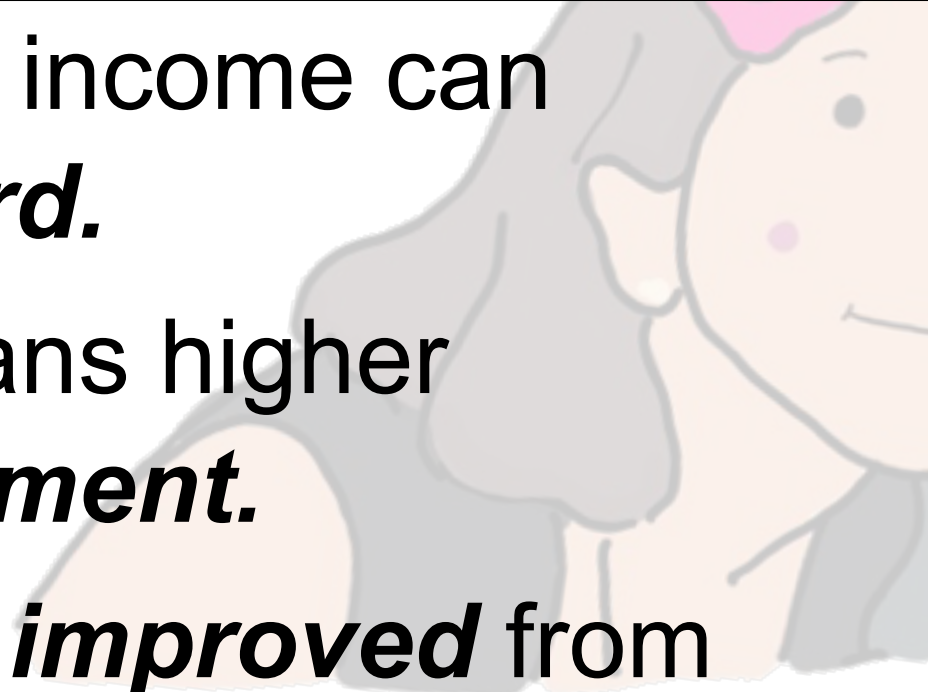
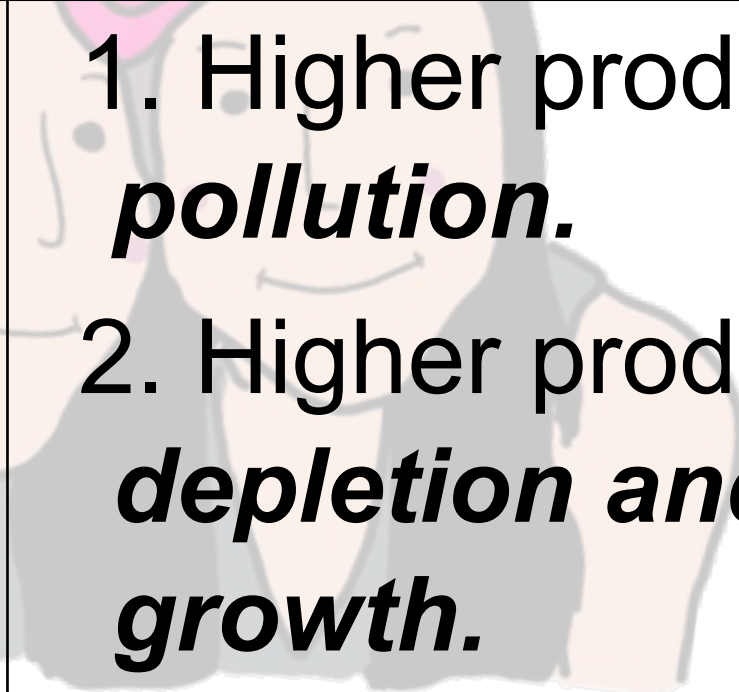
2. Causes of economic growth

Economic growth : an increase in national income and output or an increase in (real) GDP
 an increase in productive potential of an economy over the period of time

Causes of economic growth	
<p>1. An increase in aggregate demand in the short run</p> <ul style="list-style-type: none"> • $AD = C + I + G + NX$ • Investment increases due to high business confidence. • Consumption increases due to high consumer confidence. 	<p>2. An increase in AS or productive potential of an economy in long run</p> <ul style="list-style-type: none"> • Higher quantity of resources e.g. labour immigration, oil discovery. • Better quality of resources e.g. education and training. • Technological advance.

2. Consequences of economic growth

Economic growth : an increase in national income and output or an increase in GDP

Positive consequences of economic growth	Negative consequences of economic growth
 <ol style="list-style-type: none">1. Increasing output and income can improve living standard.2. Economic growth means higher production and employment.3. Government budget improved from higher tax revenue and lower spending on unemployed benefits.	 <ol style="list-style-type: none">1. Higher production leads to higher pollution.2. Higher production may cause resource depletion and unsustainable economic growth.3. An increase in production may cause workers to work overtime resulting in lower living standards.4. Economic growth maybe caused by rising AD which results in rising inflation.

3. Policies to promote economic growth

Policies to promote economic growth

1. Expansionary fiscal policy

- **An increase in government spending** increases production, resulting in higher national output.
- **A cut in income tax** increases disposable income and spending, leading to higher production.

2. Expansionary monetary policy

- **A cut in interest rate** reduces cost of borrowing. Firms borrow money to invest in capital, leading to an increase in productive potential of an economy.

3. Supply side policy

- **Education and training** improves skills of workers, leading to a rise in country's productivity.
- **Deregulation** reduces cost to firms and encourages firms to invest, resulting in higher outputs.

Limitations of policies to promote economic growth

1. The effectiveness of fiscal and monetary policies depends on **consumer and business confidence**.
2. It has **opportunity cost** from government spending.
3. It depends on **size of the policies** e.g. small cut in interest rate has little impact on economy.
4. The effectiveness of education to increase economic growth **depends on the quality of education**.

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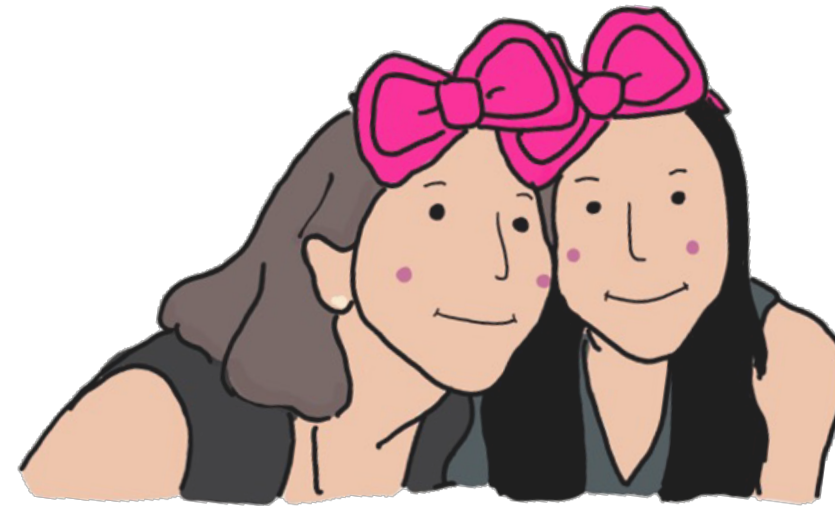
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MACROECONOMICS - Exercise

**Causes and consequences of economic growth and recession
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Exercise: MCQ

1.) What is the main measure of economic growth?

- A. Consumer price index(CPI)
- B. Output in manufacturing and service sectors
- C. Gross domestic product*
- D. Fiscal monetary and supply-side policy



Exercise: MCQ

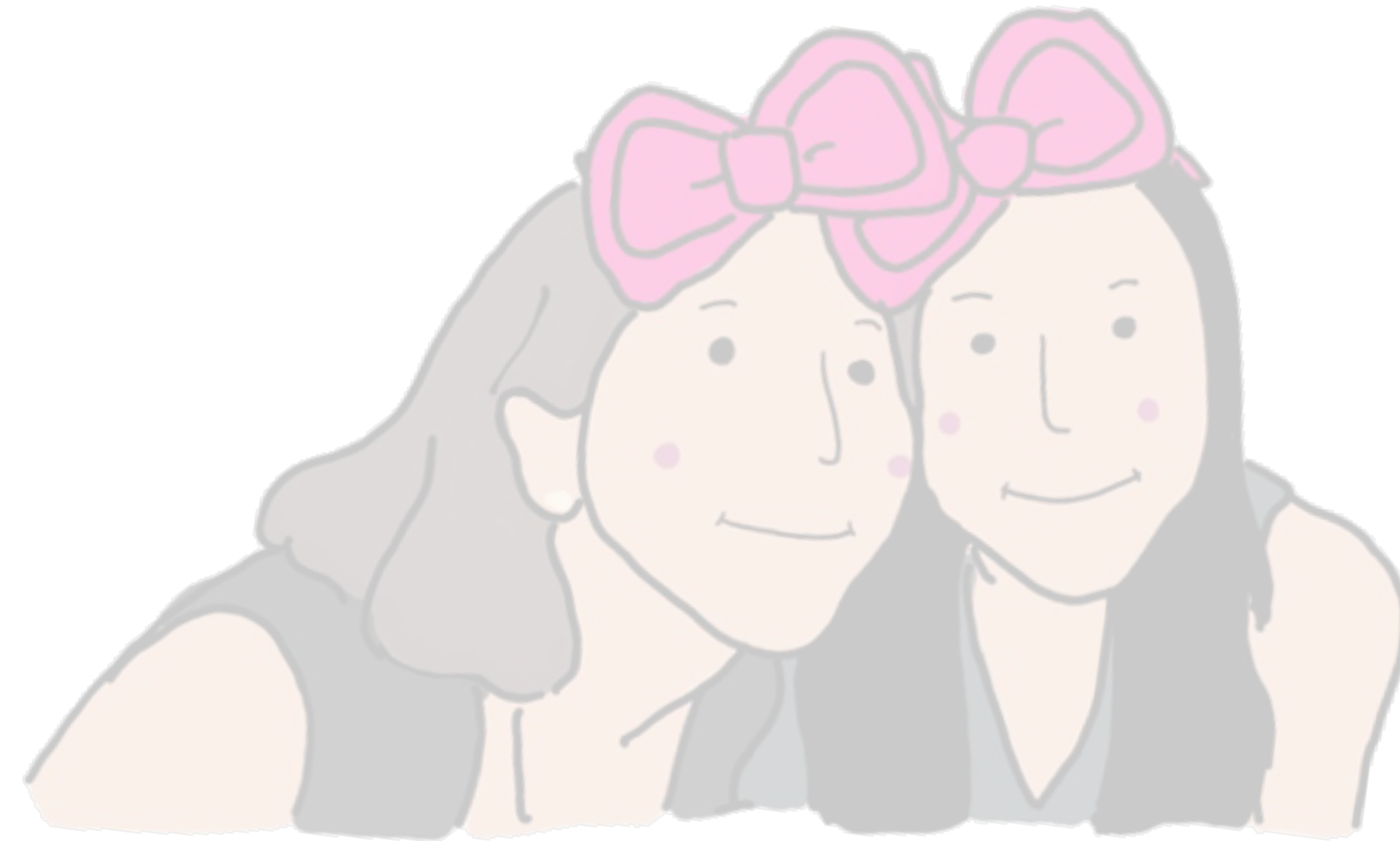
2.) Which government policy would be least likely to lead to long-term economic growth?

- A. Providing university program
- B. The construction of road
- C. The distribution of food and shelter for poor*
- D. The building of railway



Exercise: Essay

1.) Discuss whether fiscal policy is the best policy to increase economic growth. [8]



Exercise: Essay

1.) Discuss whether fiscal policy is the best policy to increase economic growth. [8]

Fiscal policy can be used to increase economic growth

- Increasing government spending
- Reducing income tax

Limitation of fiscal policy to increase economic growth

- It can cause government budget deficit.
- It can cause inflation.

Supply-side policy may be better than fiscal policy

- Providing education can increase economic growth without inflationary pressure.



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