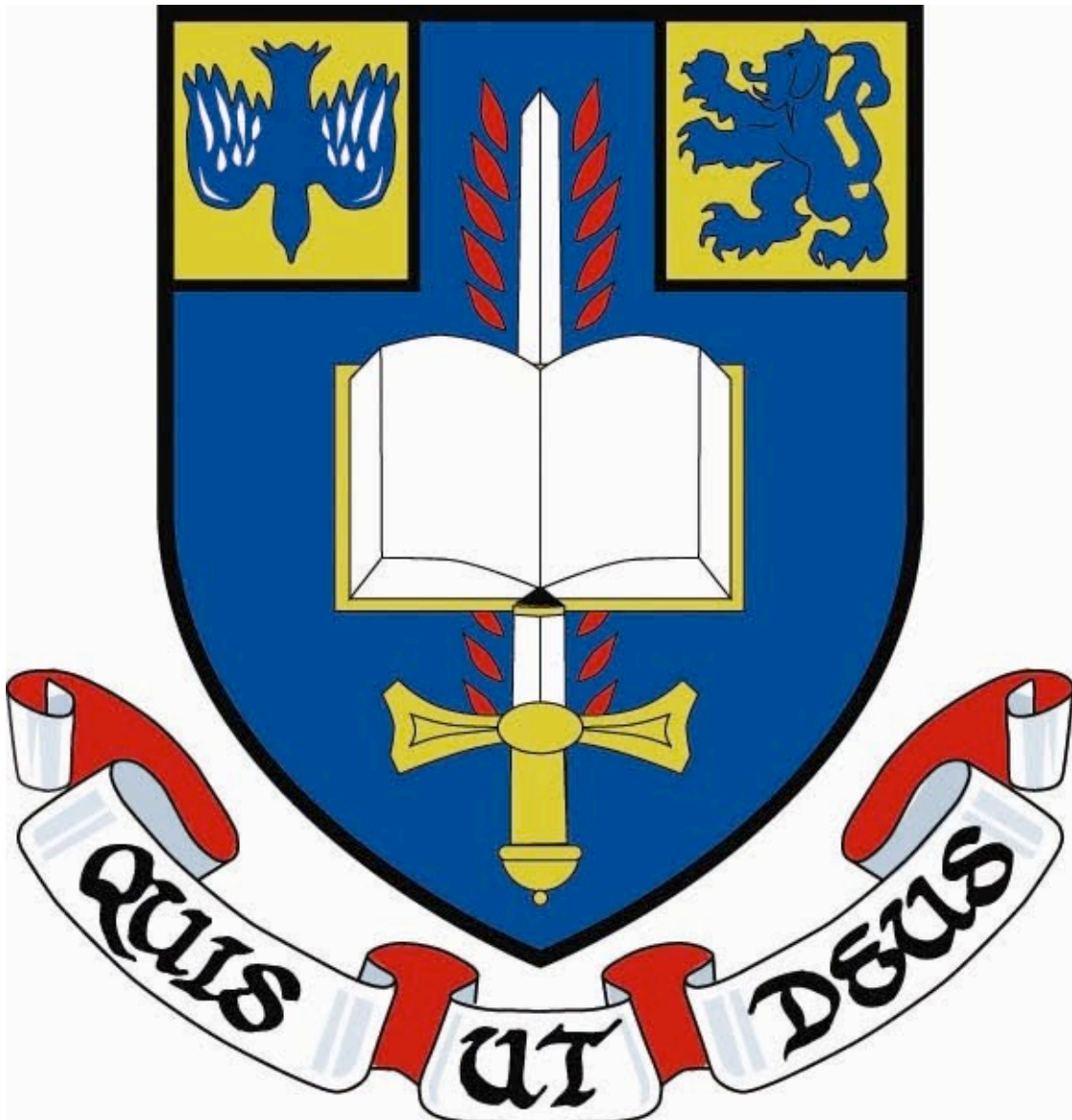

National Income 2

Mr Traynor©

Economics

Note 13 • Leaving Cert • 6th Year



National Income 2

In the previous handout, we looked at the definition of National Income (Y) and the different ways that it could be measured. We looked at the different names for the different measurements for National Income (Y) and all the adjustments that need to be made in order to calculate the different forms of National Income (Y). We looked at Real GDP, Nominal GDP and said that economists only ever look at changes in Real GDP as actual changes in the standard of living for the residents of a country. In short, the previous handout was concerned with measuring National Income (Y).

But if economists are to be any good at their job, they need to be able to tell us what affects the size of National Income (Y). After all, National Income (Y) tries to measure the standard of living enjoyed by the residents of a country. If we can find out what causes National Income (Y) to increase, then economists can accurately advise the government on how best to increase the the standard of living of the residents of their country.

But, in order to do this we must first make a distinction. The difference between the value of what an economy could produce if all the factors of production were being put to their most efficient use (The Potential Level of National Income); and the value of all goods and services that the economy actually produces (National Income).

The Potential Level Of National Income: is the maximum level of Output that the economy is capable of producing, given it's resources

If every Factor of Production was put to its best possible use in every situation, the output of the economy would reach its Potential level of National Income.

However, in practice, this never happens. The times when resources are not used to their full potential is most obvious during periods of recession. Workers are being made redundant and as a consequence are not producing things when they could be, these factors are lying idle. They could be producing something, making the country richer, but as they cannot find employment, they end up producing nothing.

What is actually produced in an economy is known as National Income (Y)

National Income (Y): The income accruing to the permanent residents of a country from current economic activity during a specified period of time, usually a year

Factors that Determine National Income (Y)

The factors listed below affect both Potential National Income and Actual National Income.

1) The Quantity and Quality of the Factors of Production:

- **Land:** Countries that have a greater quantity of land enjoy a higher potential National Income than countries with a small land mass. However, the productive capacity of that land depends on its quality. The Land mass of the United States is 9.8 Mil sq km and the Land mass of Canada is 9.9 Mil sq km. Canada's land mass is bigger than the United States of America, but, as huge amounts of Canada is uninhabitable, this leads to a much lower actual output for Canada. The GDP of Canada (2010) is US\$ 1.499 trillion. The GDP of the US is US\$ 14.527 trillion. Of course not all of this difference is due to the amount of available land, the other factors of production are just as important.
- **Labour:** The supply of Labour in a country also effects the level of Potential National Income. The greater the quantity of Labour available in a country, the more goods and services that can be produced. However, the greater the level of skill, training, education and motivation of workers in a country, the greater the level of Potential National Income. The size of the Labour Force in Canada (the amount of people who are either working or looking for a job) is 18.58 million workers (2010). The size of the Labour Force in the United States (the amount of people who are either working or looking for a job) is 154.5 million workers (2010).
- **Capital:** A large capital stock in a country (a large number of machines) results in a greater productive capacity and as such a higher Potential National Income. But unless these machines are advanced and well maintained Potential National Income will be reduced. The total Value of the Capital stock in Canada is US\$ 503.72 billion. The total Value of the Capital stock in the United States is US\$ 2.398 trillion.
- **Enterprise:** while the amount of enterprise is impossible to measure, it really is the most important of all the factors of production. Without enterprise, all other factors of production would do nothing. The greater the amount of entrepreneurs and the greater their ability to organise the other factors of production, the greater the level of Potential National Income.
- When you get to college and study economics, you will see that the only thing that affects the size of Potential National Income is the only the quantity and quality of the factors of production. This is true for the long run only. In the long run, the quantity of money has no influence

on the size of Potential National Income. This is known as Money Neutrality. In the short run however, the quantity of notes and coins can effect the level of output produced. But we will leave most of that for college.

The Components of GDP

We have just looked at how the factors of production control the Potential Level of National Income in the Long Run. We know that the manner in which these productive resources are used defines the wealth of a nation and if they are not put to their best use, then Actual National Income will be less than Potential National Income.

To understand how the economy is using its scarce resources, economists are often interested in looking at what people in an economy are spending their money on. To do this National Income (Y) is divided into 5 components. These components are

- The money that is spent on Consumption (C).
- The money that is spent on Investment (I)
- The money that is spent by the Government (G)
- The money that is spent on Exports (X)
- The money that is spent on Imports (M)

In order to make this relationship between all the components and National Income easier to see, economists have put these components into an equation.

$$Y = C + I + G + (X - M)$$

This equation is an identity. An Identity is an equation that must be true by the way the variable in the equation are defined. In this case, because each euro of expenditure included in National Income is placed into one of the five components of National Income, the total of the five components must be equal to National Income. We will now look at each of the five components in detail.

While it is a good idea to be aware of what is included in each of these components, it is not necessary to learn them off. However, you do need to know, off by heart, what factors influence the size of each of these components.

Consumption (C)

Consumption is spending by households on goods and services. “Goods” include spending by households on durable goods like cars, fridges etc and non durable goods like food and clothing. “Services” include such intangible items like haircuts and solicitors services.

Factors that determine the amount of Money spent on Consumption in an Economy

- 1) **Levels of Incomes:** as income rises, the level of spending tends to rise.
- 2) **Marginal Propensity to Consume (MPC):** the higher the MPC, the higher will be the level of spending.
- 3) **Availability of Credit:** as credit becomes more easily available the level of spending will rise.
- 4) **Rate of Interest:** Currently interest rates are increasing and with borrowing falling, spending will fall.
- 5) **Rates of Taxation:** if these increase, disposable income falls and spending will fall.

Investment (I)

Investment is the purchase of goods that will be used in the future to produce more goods and services. It is the total of purchases of capital equipment, inventories and structures. Investment in structure includes the spending on new housing.

The treatment of inventory is something somewhat unusual. When Apple produces a computer and, instead of selling it, Apple adds the computer to it's inventory. Apples is assumed to have “purchased” the computer for itself. This means that national income accounts treat the computer as part of Apple's investment spending. If Apples then sells the computer out of inventory, Apple's inventory investment will be negative, offsetting the positive expenditure of the buyer.

Inventories are treated this way because one aim of National Income is to measure the value of the economy's production and goods added to inventory are part of that production.

Factors that determine the amount of Money spent on Investment in an Economy

- 1) **Rate of Interest / MEC:** As interest rates rise, borrowing becomes more expensive and investment tends to fall.
- 2) **Expectations of business people:** Are they optimistic about the future? Does government policy favour risk taking; are the levels of taxation conducive to risk-taking etc. If business people believe that there is a positive economic future then they will take the risk of setting up a business, in order to produce goods and services that people want.

Government Purchases (G)

Government Purchases includes spending on goods and services by local and national government. It includes the salaries of government workers and the spending on public works.

It is important that you are clear on what actually counts as government purchases. When the government pays the salary of a teacher, this salary is part of government purchases. However, when the government pays job seekers allowance to someone who is unemployed, this is not included as part of government purchases.

Such a government spending is known as a transfer payment as it is not a payment made in return for the supply of a factor of production. Transfer payments alter household income but they do not reflect any change in the production by the economy. Because National Income is intended to measure income from, and expenditure on, the production of goods and services, transfer payments are not counted as part of government purchases.

Factors that determine the amount of Money spent on Government Purchases in an Economy

- 1) **Decisions of Politicians:** Primarily depends on the political decisions of the government and the type of fiscal policy being pursued by the state.

Exports (X)

Exports are the purchase of domestically produced goods by foreigners. This is where money comes into Ireland and goods (computers, electronics etc) or services (financial or accounting services) leave the country. Exports are generally seen as good things.

However, all along the course, we have said that the wealth of a nation is decided by what is produced. The more that is produced in an economy, the wealthier that economy is as there are more goods and services to share among the residents of that country. But if we export goods and services, there is less available to share among the residents. So, how can imports be seen as a good thing.

The answer is that exports are seen as a form of national saving. Just ignore the idea of money for a second. If you give something to somebody, you expect the to give you something in return. The same is true on a massive scale for countries. When companies in Ireland sells goods and services to companies in other countries, they earn extra money which can then be used to buy goods and services of companies in that country in the future.

When a country exports they are consuming less than they produce now, in order to consume more than they produce in the future.

Factors that determine the amount of Money spent on Exports in an Economy

- 1) **Income levels in our Export Markets:** if high then the demand for Irish exports may increase.
- 2) **Competitiveness of Irish Exports:** levels of domestic inflation v. international rates. If our goods are competitive on export markets then demand may increase.
- 3) **Value of the Euro in Relation to Other Currencies:** e.g. the US dollar / Pound Sterling.

Imports (M)

Imports are the domestic purchases of foreign goods. In National Income Statistics, imports are subtracted from National Income. The reason that this is done is that the imports of goods and services are included in other components of National Income.

E.g. Suppose an Irish consumer buys a €30,000 car from Volvo, the Swedish carmaker. This transaction increases consumption by €30,000, as car purchases are part of consumer spending. But this car was not produced by Irish owned factors of production (and National Income is trying to measure the value of all the goods and services produced by Irish owned factors of production). So we need to subtract this amount from National Income. Therefore, consumption is up €30,000 and imports (a minus figure) is down €30,000, and National Income remains unchanged.

In other words, imports are goods and services produced abroad are subtracted from National Income because they are included in either Consumption, Investment or Government Purchases as a positive figure.

Therefore, when a domestic household, firm or government purchases a good or service from abroad, this good is added to National Income in either Consumption, Investment or Government Purchases and then is taken away from National Income in Imports, leaving National Income unchanged.

Factors that determine the amount of Money spent on Imports in an Economy

- 1) **Levels of incomes:** as income rises, the level of spending on imports tends to rise.
- 2) **MPM:** the higher the MPM the higher will be the demand for imports.
- 3) **Value of the Euro in Relation to Other Currencies** e.g. the US dollar / Pound Sterling.

The Circular Flow of Income

In order to fully understand the workings of an economy and the nature of National Income, we must take a look at what is called The Circular Flow of Income. The Circular Flow of Income is a basic model of how any economy works.

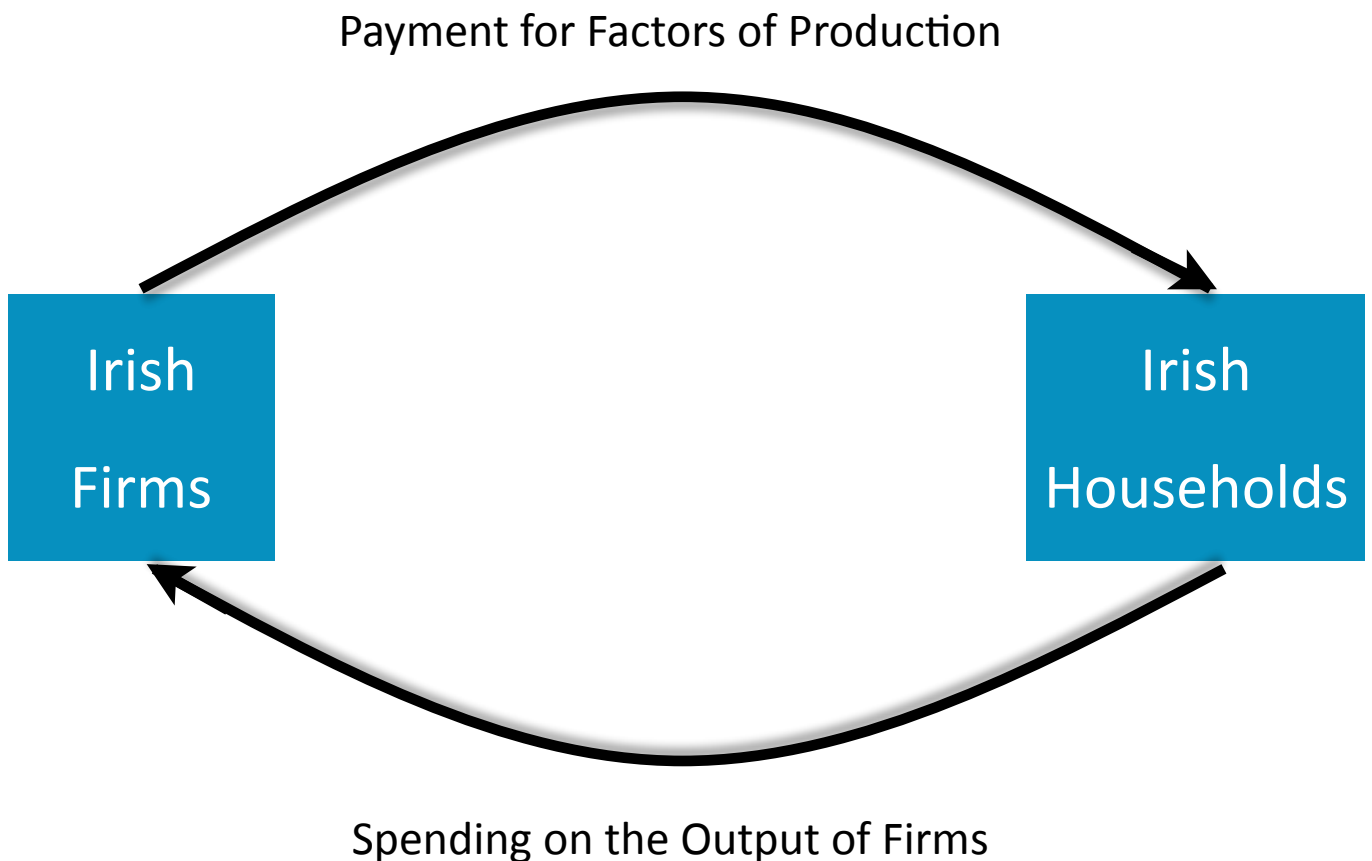
Remember, there are three ways to calculate National Income (Y)

- The Output Method
- The Expenditure Method
- The Income Method

The Circular Flow of Income diagram looks at the flow of money through different agents (People, firms, the government and foreigners) around the economy.

We will begin our analysis of The Circular Flow of Income diagram with its simplest version. One with just Irish firms and Irish households.

The Circular Flow of Income (Irish Firms and Irish Households)

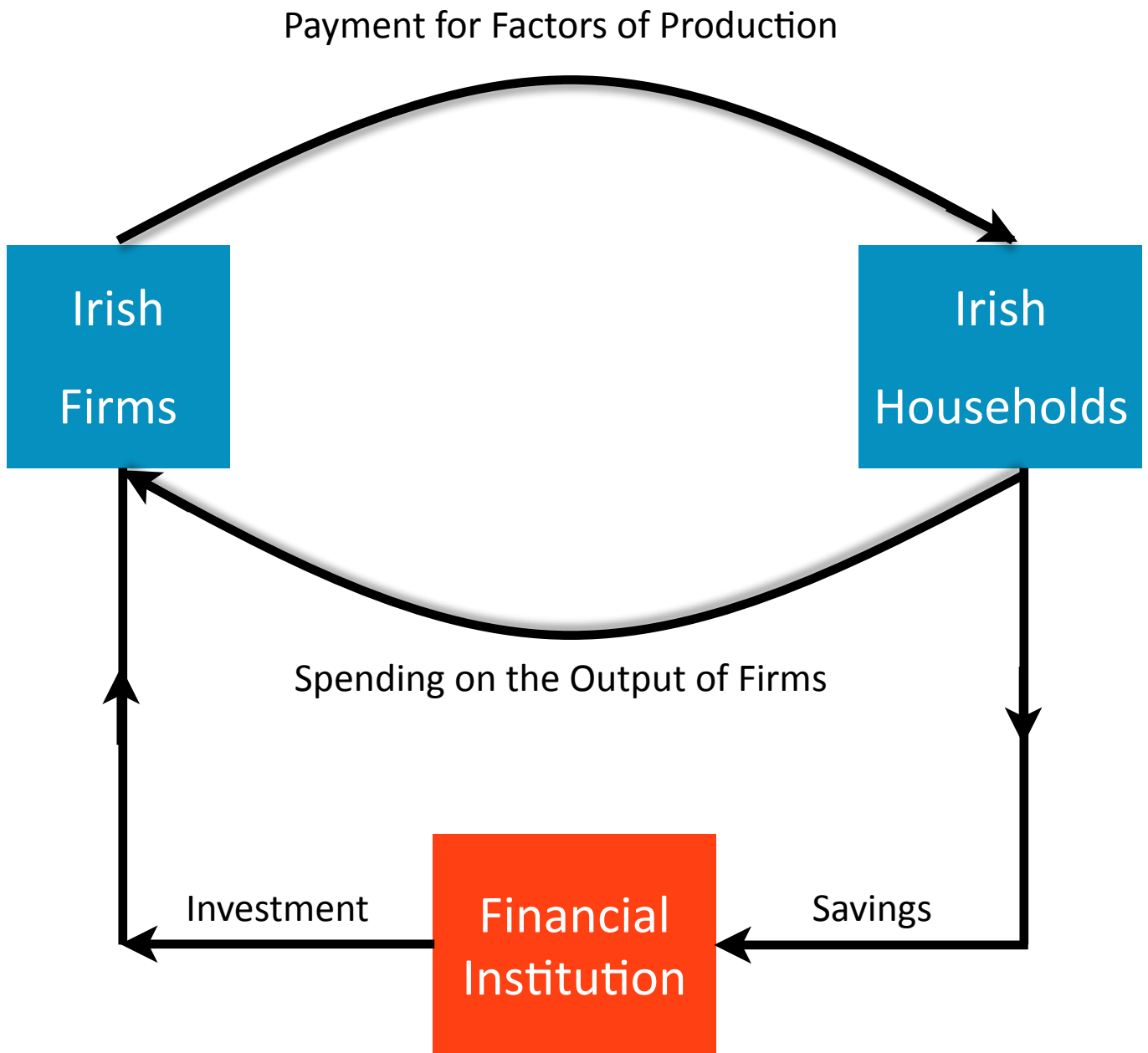


- Irish households supply the factors of production (labour) necessary for firms to make their products. In return for this supply of labour, firms pay workers a wage.
- Once households receive this payment for their work (wages), they then spend this money on the goods and services that firms produce.

The above diagram would represent the real world perfectly if households spent all their money on all the output of firms. But, in reality, this is not true.

Households do not spend all of their money but save some of it in financial institutions like banks. In turn, banks use these savings to provide the funds for other and people and businesses to invest.

This brings us onto the next stage of the Circular Flow of Income Diagram

The Circular Flow of Income (Financial Institution)

- As we said, some households save some of their income.

Savings: The proportion of income that is not spent.

$$Y = C + S$$

- If households increase their savings, the only way that this can be done is if they reduce their consumption. This reduces the circular flow of income and is known as a leakage.

A Leakage: is a reduction in the circular flow of income

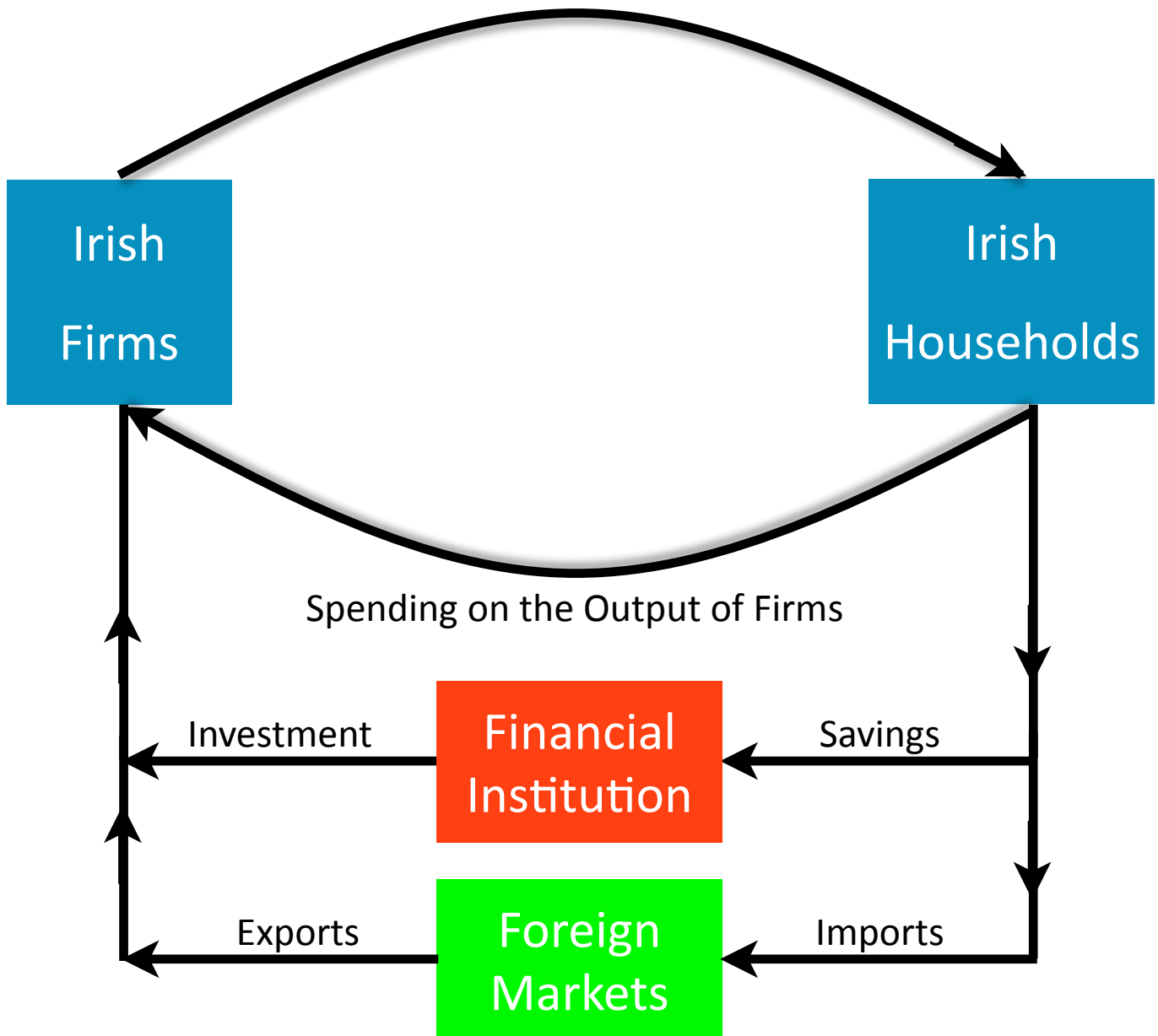
- Leakages cause National Income to fall, leading to a drop in demand for goods and services or a reduction in economic activity, which causes the demand for labour to fall. Leakages cause the level of unemployment to rise.
- Financial Institutions however use the money that depositors save with them to finance investment by other people.
- Investment Expenditure is the money spent on the production or purchase of capital goods by individuals, households or firms.
- Investment increases the circular flow of income and is known as an injection.

An Injection: is anything that causes a rise in the circular flow if income

- Injections cause National Income to increase, leading to an increase in the demand for goods and services or an increase in economic activity. This increase in economic activity causes an increase in the demand for labour. Injections cause the level of unemployment to fall.
- Again, the above model does not accurately represent the real world as households do not spend all of their money on goods and services that were produced in Ireland (Domestically produced goods).
- Also, Irish firms do not sell all of their output to Irish Households, but they export some of their produce for sale in foreign countries. To examine the effect that this would have on the Circular Flow of Income diagram, we must take a look foreign markets.

The Circular Flow of Income (Foreign Markets)

Payment for Factors of Production



- Irish households spend some of their money on imports.

Imports: Money spent by Irish citizens on goods and services produced outside of Ireland

- If Irish households buy imports, that means that money is leaving the country. This reduces the circular flow of income and as such is a leakage.

A Leakage: is a reduction in the circular flow of income

- However, Irish firms can sell some or all of their produce on foreign markets which are known as exports.

Exports: Money spent by foreign individuals on goods and services produced within Ireland.

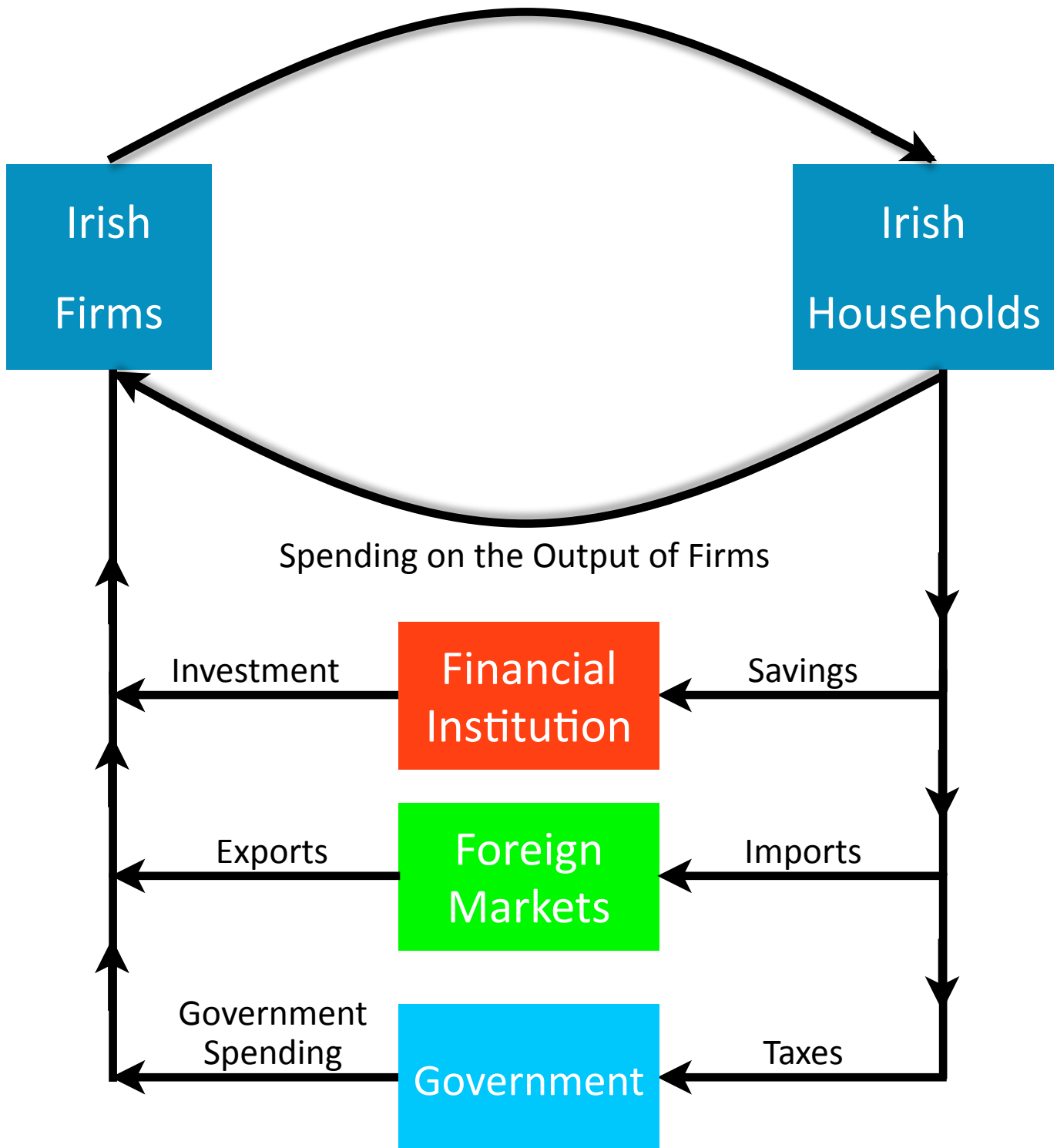
- If Irish firms sell exports, that means that money is coming into the country. This increases the circular flow of income and as such is an injection.

An Injection: is anything that causes a rise in the circular flow if income

- The model developed above is missing just one sector. Unfortunately, households do not get to keep all that they earn. The government takes some of this income in the form of taxes and then spends this income on the output of firms in the form of government expenditure.

The Circular Flow of Income (Government Sector)

Payment for Factors of Production



- Households cannot keep all of their hard earned money. The government takes some of this money in the form of taxation.

Taxation: a contribution required of persons, groups or businesses for the support of the government

- If the government increases the taxes that households have to pay, this means that households have less money available to them to purchase the output of firms.
- This reduces spending within a country and thus reduces the circular flow of income.
- As a result of this, taxation is a leakage.

A Leakage: is a reduction in the circular flow of income

- However, the government can use some of this revenue, generated through taxation, to purchase some of the output produced by firms.
- It does this through government spending

Government Spending: All the money spent by the government which includes both Current and Capital Spending

- As this is an increase of money into the circular flow, Government Spending will increase the national flow of income. As such government spending is an injection.

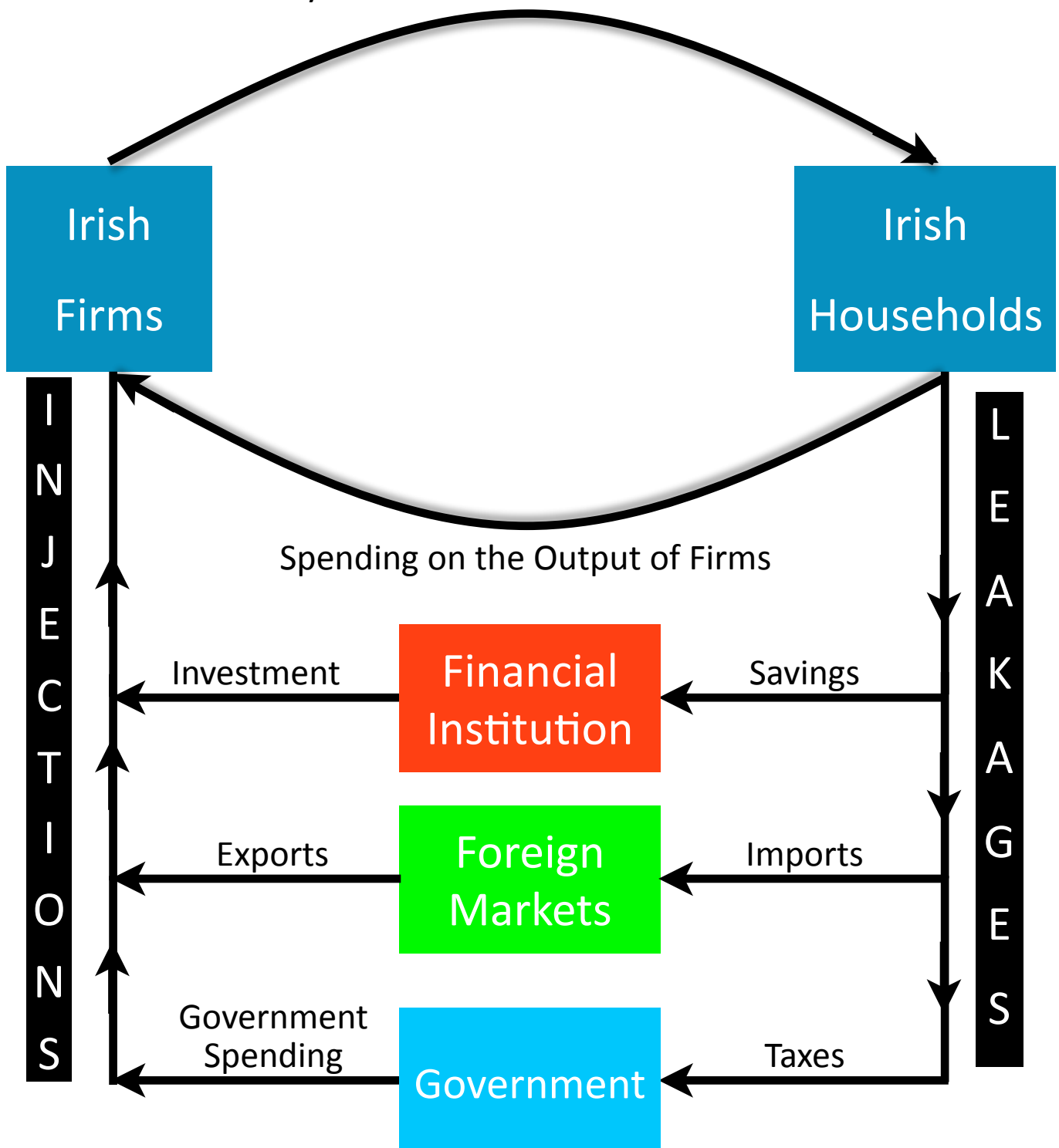
An Injection: is anything that causes a rise in the circular flow if income

Summary of The Circular Flow of Income

The Circular Flow of Income is a basic model of how any economy operates. It tries to trace the flow of money around the economy. When extra money is added to the economy, it increases Aggregate Demand. That means that there is an increase in the amount of goods and services that are bought. The more injections that occur in the Circular Flow of Income, the greater the level of Aggregate Demand, which means the more people that are employed. The more people that are employed, the more goods and services that are produced and therefore the richer the residents of the economy are.

The Circular Flow of Income

Payment for Factors of Production



Explaining The Circular Flow of Income

- Households supply the Factors of Production (e.g. Labour and Enterprise) to firms.
- Firms pay households for the supply of these Factors of Production.
- Households, in turn, spend their income on the output of firms. This then become the firms income.
- Households do not spend all of their income on the output of firms. Some of it is saved. This is a leakage from the Circular Flow of Income and results in reduced economic activity. In short, as a result of this saving, everyone is poorer. National Income is reduced.

A Leakage: is a reduction in the circular flow of income

- However, the incomes that households save can be used to provide the funds for firms to invest.
- This investment represents an injection in the Circular flow of Income. In short, as a result of this investment, everyone is richer. National Income is increased.

An Injection: is anything that causes a rise in the circular flow if income

- Some of the income earned by households is spent on imports. This is a leakage and creates wealth abroad, but reduces wealth here. Imports reduce National Income and are a leakage.
- Exports are goods that are produced in Ireland but are sold abroad. Exports represent an injection and as such increase the Circular Flow of Income. They make the residents of a country richer. Exports increase National Income and are an injection.
- Some of the income of households is taxed and goes to the government. This money represents a leakage and reduces the circular flow of income. It makes people poorer. Government taxes reduce National Income.
- When the government spends some of the money that it got from taxation on the output of domestic firms, this is an injection into the Circular Flow of Income. It makes everyone in the economy richer. Government spending increases National Income.
- If injections are greater than leakages, Aggregate Demand increases. This causes National Income to increase and causes unemployment to fall.

- If leakages are greater than injections, Aggregate Demand falls. This causes National Income to fall and causes unemployment to rise.

The Multiplier

As we can see from the Circular Flow of Income diagram, any injection into the circular flow of income results in an increase in Aggregate Demand. As Aggregate Demand increases,

- More Goods and Services are bought.
- When more goods and services are bought, employers need more workers.
- When more workers are hired, there is more produced in the economy.
- This means that the residents of the economy are richer and their standard of living is higher.
- This is shown as an increase in National Income statistics.

Likewise, any leakage out of the circular flow of income (out of the economy), which results in a decrease in Aggregate Demand. As Aggregate Demand decreases,

- Less Goods and Services are bought.
- When less goods and services are bought, employers need less workers.
- When workers are fired, there is less produced in the economy.
- This means that the residents of the economy are poorer and their standard of living is lower.
- This is shown as a decrease in National Income statistics.

Injections and Leakages

It would generally accepted that one of the roles or jobs of the government is to try to increase the standard of living of the residents of the country. We have seen from our study of the Circular Flow of Income diagram that government spending is an injection and if the government were to increase government spending by €100 million, then National Income would increase.

However, the surprising result from this is that an increase in government spending (an injection of €100 million), leads to a greater increase in National Income (an increase in National Income of more than €100 million).

This effect of an injection into the economy causing a greater increase in National Income than the initial injection is called the multiplier effect.

The same is true for any leakage. To continue on with our example of government, if the government were to raise taxes and from this increase in taxes they were to receive an extra 100 million in tax revenue, this increase in taxes would cause National Income to drop by more than €100 million.

This effect of a leakage out of the economy causing a greater decrease in National Income than the initial leakage is called the multiplier effect.

The Multiplier: shows the relationship between an initial injection into the circular flow of income and the eventual total increase in National Income resulting from this injection

E.g. Ross gets €10 in pocket money. He spends €8 on a haircut. The hairdresser spends €7 of this on groceries in a local shop. The shopkeeper spends €5 of this on a taxi. The initial injection of €10 into the economy has increased National Income by €30.

Ross = €10 + Hairdresser €8 + Shopkeeper €7 + Taxi driver €5 = €30

The Size of the Multiplier

The size of the multiplier depends on the following.

- 1) The Marginal Propensity to Consume.
- 2) The Marginal Propensity to Save.
- 3) The Marginal Propensity to Tax.
- 4) The Marginal Propensity to Import.

We will now look at each of them individually

Marginal Propensity to Consume (MPC)

Marginal Propensity to Consume (MPC): is the fraction of any extra income which is spent on consumption

If I earn an extra €1 and I spend 80c of it on consumption goods, then my MPC is

$$\frac{80}{100} = 0.8$$

$$MPC = \frac{\Delta C}{\Delta Y}$$

Where ΔC = The change in Consumption

ΔY = The change in Income

The higher the MPC (the closer it is to 1), the greater the effect that any injection (or leakage) will have on National Income.

In short, the bigger the MPC, the bigger the Multiplier.

Marginal Propensity to Save

Saving is that portion of Income which is not spent

$$Y = C + S$$

If I earn an extra €1 and I spend 80c of it on consumption goods, then I have saved 20c of it. Therefore, my Marginal Propensity to Save is

$$\frac{20}{100} = 0.2$$

Marginal Propensity to Save (MPS): is the fraction of any extra income which is saved

$$MPS = \frac{\Delta S}{\Delta Y}$$

Where ΔS = The change in Savings

ΔY = The change in Income

From the above examples, we should be able to see that $MPC + MPS = 1$. The reason for this is that if money is not spent, by its definition, it must have been saved. Therefore $MPC = 1 - MPS$ and conversely $MPS = 1 - MPC$

The bigger the MPS, the smaller the Multiplier

Average Propensity to Consume (APC): is the fraction of total income which is spent on consumption.

$$APC = \frac{C}{Y}$$

Average Propensity to Save (APS): is the fraction of total income which is saved.

$$APS = \frac{S}{Y}$$

Again, $APC + APS = 1$

$$APC = 1 - APS$$

$$APS = 1 - APC$$

The Marginal Propensity to Tax

Marginal Propensity to Import (MPM): is the fraction of any extra income which is spent on imports

If I earn an extra €1 and I spend 10c of it on imported goods, then my MPM is

$$\frac{10}{100} = 0.1$$

$$MPM = \frac{\Delta M}{\Delta Y}$$

Where ΔM = The change in Imports

ΔY = The change in Income

The bigger the MPM, the smaller the Multiplier

Marginal Propensity to Tax

Marginal Propensity to Tax (MPT): is the fraction of any extra income which is paid in taxes

If I earn an extra €1 and I have to pay 30c of it to the government in taxes, then the MPT is

$$\frac{30}{100} = 0.3$$

$$MPT = \frac{\Delta T}{\Delta Y}$$

Where ΔT = Change in taxes paid to the government

ΔY = Change in income

The bigger the MPT, the smaller the Multiplier

Different Versions of the Multiplier

There are many different versions of the Multiplier. It can include any combination of MPC (or MPS as these are opposite sides of the same coin), MPM or MPT. However, in general, there are three main versions that are used.

- 1) The Multiplier for a Closed Economy (an economy that does not trade with any other countries) with no Taxation.

$$\frac{1}{1 - MPC} \quad \text{Or} \quad \frac{1}{MPS}$$

- 2) The Multiplier for an Open Economy (an economy that trades with other countries) with no taxation

$$\frac{1}{(1 - MPC) + MPM} \quad \text{Or} \quad \frac{1}{MPS + MPM}$$

3) The Multiplier for an Open Economy that includes Taxation

$$\frac{1}{MPS + MPM + MPT} \quad \text{Or} \quad \frac{1}{(1 - MPC) + MPM + MPT}$$

Examples 2011

- (b) (i) Explain what is meant by the term 'Multiplier'.
(ii) It has been estimated that in the Irish economy:
MPT = 0.22, MPM = 0.30, MPS = 0.28.
Calculate the value of the Multiplier in the Irish economy.
(iii) Outline briefly how taxes affect the value of the Multiplier.

(25)

Answer

- (i) The multiplier:

The multiplier shows the relationship between an (initial) injection into the circular flow of income and the eventual total increase in national income resulting from the injection.

8 marks

- (ii) Calculate the multiplier

Method 1	Method 2
$\frac{1}{MPS + MPT + MPM}$ $\frac{1}{0.28 + 0.22 + 0.3}$ $\frac{1}{0.8}$ <p>1.25</p>	$MPC = 1 - MPS = 1 - 0.28 = 0.72$ $\frac{1}{1 - (MPC - MPT - MPM)}$ $\frac{1}{1 - (0.72 - 0.22 - 0.3)}$ $\frac{1}{0.8}$ <p>1.25</p>
8 marks	8 marks

- (iii) Outline briefly how taxes affect the value of the Multiplier

1. Taxes decrease spending within the economy / taxes are a leakage from the circular flow of national income.
2. When spending decreases less economic activity is generated within the economy.
3. The value/the magnitude of the multiplier decreases.

Example 2009

- (a) The following table shows the level of National Income its Consumption, Investment and Export components at the end of periods 1 and 2, and the level of Imports at the end of period 1. (For the purpose of this question you may ignore the Government sector).

	National Income	Consumption	Investment	Exports	Imports
Period 1	€40,000	€30,000	€15,000	€15,000	€20,000
Period 2	€50,000	€39,000	€18,000	€21,000	?

Calculate the following, showing all your workings:

- Level of imports at the end of period 2;
- Level of savings at the end of period 2;
- Marginal Propensity to Consume (MPC);
- Size of the Multiplier.

(20 marks)

Answer**(i) Imports at the end of period 2**

$$\begin{aligned}
 \text{GNP} &= C + I + X - M \\
 50,000 &= 39,000 + 18,000 + 21,000 - M \\
 50,000 - 39,000 - 18,000 - 21,000 &= -M \\
 50,000 - 78,000 &= -M \\
 -28,000 &= -M \\
 M &= 28,000
 \end{aligned}$$

(ii) Savings at the end of period 2

$$\begin{aligned}
 \text{GNP} - C &= S \\
 50,000 - 39,000 &= S \\
 S &= 11,000
 \end{aligned}$$

(iii) Marginal Propensity to Consume

$$\begin{aligned}
 \text{MPC} &= \frac{\Delta C}{\Delta \text{GNP}} \\
 \text{MPC} &= \frac{9,000}{10,000} \\
 \text{MPC} &= 0.9
 \end{aligned}$$

(iv) Size of the Multiplier

$$\begin{aligned}
 &\frac{1}{1 - (\text{MPC} - \text{MPM})} \\
 &\frac{1}{1 - (0.9 - 0.8)} \\
 &\frac{1}{1 - 0.1} = \frac{1}{0.9} = 1.11
 \end{aligned}$$

$ \begin{aligned} \text{MPM} &= \frac{\Delta M}{\Delta \text{GNP}} \\ \text{MPM} &= \frac{8,000}{10,000} \\ \text{MPM} &= 0.8 \end{aligned} $

Effects of Economic Growth

Positive Effects

- 1) **Increased Employment:** Economic growth will lead to increased demand with more labour being demanded to produce this.
- 2) **Improved Government Finances:** With a rise in spending – indirect tax revenue rises; more people at work will result in an increase in direct tax revenue; expenditure on social welfare should fall.
- 3) **Effects on Balance of Payments:** If the increase in the rate of economic growth is export led then the balance of payments position improves.
- 4) **Improved Standard of Living:** Economic growth will result in increased wealth in the economy allowing us to buy more goods and services / a reduction in poverty / better state services.
- 5) **Effects on Migration:** If jobs opportunities exist then people who had planned to emigrate may stay here and more immigrants may be attracted to the economy.
- 6) **Investment Opportunities:** Economic growth indicates a growing economy and this may attract additional investment.

Negative Effects

- 1) **Use of Scarce Resources:** Economic growth results in an increased demand for scarce resources e.g. oil. The increased demand may involve damage to the environment.
- 2) **Increased Demand for Imports:** Economic growth increases incomes and spending power and demand for imports may rise, worsening the balance of payments position.
- 3) **Revised Expectations by Citizens:** With economic growth citizens may alter their expectations of government and expect more services from the state e.g. revised taxes; growth in incomes; wage demands etc.
- 4) **Uneven Distribution of Wealth:** If the increase in wealth is not fairly distributed then the gap between rich and poor may widen.
- 5) **Inflationary Pressures:** With a rise in the level of economic activity the level of demand- pull inflation will rise.