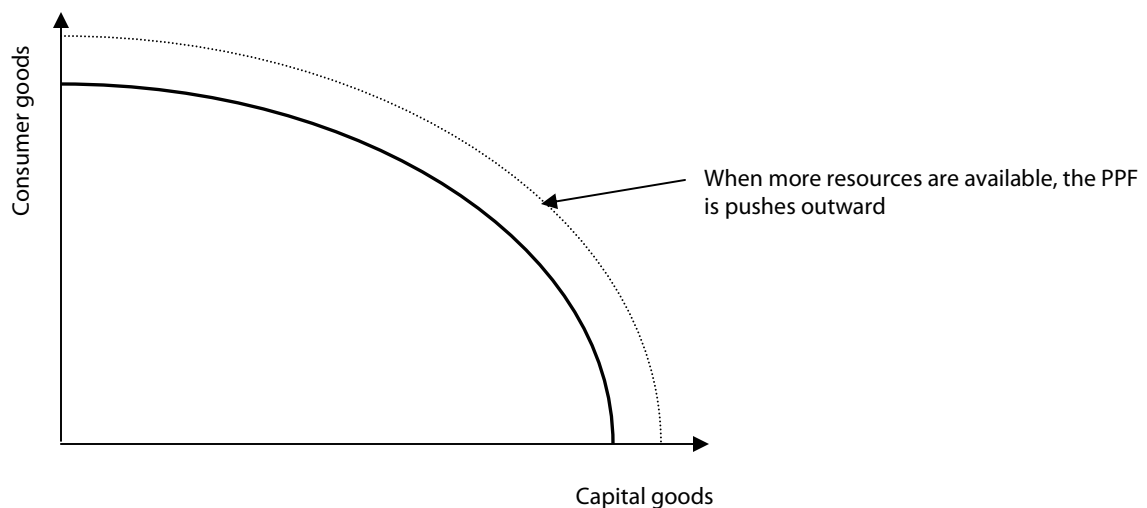


## Economic growth questions

### 1. a. What is economic growth?

Economic growth is the increase in national output. Most often this is measured using real GDP, the gross domestic product per annum. This is the value of all goods and services produced by factors of production based in the UK. The rate of inflation is not included in the real GDP and so the increase year on year of the real GDP shows the economic growth.

On a PPC growth is the shift outwards in potential capacity of the economy (From the solid line to the dotted line).



### 1. b. Compare the growth performance of the six industrialised countries shown in Figure 26.7 (Anderton p.172)

During the period 1950 to 1990 in general the six industrialised countries have witnessed a fall in the rate of growth of their economies. Growth rates of the six countries have always been positive. This means that, on average for the decade the countries GDP has increased, although at times at a lower rate.

Japan experienced very high economic growth in the '50s and '60s, nearly 5 times that in Britain at the time. This was due to the movement of workers from agricultural jobs to more productive labour. Between the '60s and the '70s there was a sharp decline and the rate of increase of the growth fell to less than half from ~10.2% p.a. to ~4.6% p.a.. In the '80s the growth rate was similar, but then fell again in the '90s to ~0.9% p.a..

Germany, Italy and France all experienced a similar decline in growth rate in the '70s through to the '90s, falling from around 3% to around 1% during this period.

In the '50s and '60s all three of these countries experience a higher growth rate. In the '50s Germany had a very high growth rate, very near to that of Japan. In the '60's this halved from just under 8% to just over 4%.

There was no change in the growth rate for Italy, remaining at ~5.5% through the '50s and '60s. France experienced an increase in growth proportionally similar to that which Japan experienced through the '50s and '60s.

The US and Britain have had considerably more stable and lower growth rates. The US growth rate has fluctuated between ~3.7% and ~2.2%, reaching the height during the '60s.

In Britain the growth rate has been approximately 2.2%, although during the '70s this dropped to ~1.5% and in the '90s to just under 2%.

Countries to the left of the graph have experienced a higher fluctuation in growth rates than those to the right. The countries are ordered Japan, Germany, Italy, France, US and Britain. Japan has experienced the greatest fluctuation in growth rates, nearly 10% over the period. Britain, to the other side of the graph has experienced a fluctuation of lower than 2%.

For the first three decades Britain experienced the lowest growth rates of the six countries. However, the growth rate has had a relatively low fluctuation and during the '80s and '90s ceased to experience the lowest growth rates.

The countries with a higher growth rate have experienced a higher fluctuation. High growth rates is often linked to short term benefits. They can cause stress and anxiety amongst a population. When Japan experienced high growth rates workers had to put in long hours and students felt pressured. High growth rates may also lead to damaging the environment, using lots of oil for example. Sustainable economic growth is possible however using renewable fuel sources and recycling raw materials.

### **3. Discuss what other strategies European countries could adopt to increase their growth rates.**

By concentrating on education and investing in improving the quality of the work force skills will be learnt to a higher level and a broader range of skills learnt. This will cause higher output as a more qualified individual will create more valuable output from the same resources. Also an individual will be more mobile in their job and have the ability to change from one job to another as required.

However, education requires a large, primarily capital, investment. One way of financing such a move would be to increase tax, yet this will have the affect of reduced savings, and so less gross domestic fixed capital formation. This may

therefore lead to short term losses for long term gains as the benefits of education take time to be seen.

Research and development, specifically into civilian projects is the fundamental cause of economic growth. New products or improved versions of older products encourage more spending. If the marketplace were stagnant and there was no development there would be no incentive for consumers to spend an increase in income.

Research and development can also lead to a fall in prices as production becomes more efficient. This can lead to economic growth as fewer factors of production are involved in the production of the same good or service so more factors of production are available for an alternative use. A decrease in the price of a good increases the demand for a good as more people are able to buy it (and if willing) this will cause economic growth. Again this requires short term losses in investment for the long term gain of greater economic growth.

To achieve economic growth through either education or research and development an end to the short term attitude within our economy must be found. Investment in companies is motivated by the availability of dividends and share holders are more interested in larger short term dividends than re-investment.

This is due to the financial system within Britain. The US has a very similar situation. Countries like Germany, France, Italy and Japan however work differently. There banks themselves invest in companies instead of loaning money to companies who then invest the money. This means that they are more interested in the long term success of a business than of short term success.

However, those in favour of the system in place in the US and Britain argue that the mask of long term investment can be used to disguise poor decisions. This single policy has not worked particularly well as the information in Figure 26.7 (Anderton, p.172) shows, in the later part of the period all 4 countries with the long term investment strategy have lower growth rates. This suggests that any single policy alone cannot lead to economic growth, but a combination.