

# **Economic Growth**

**AS Economics Presentation  
2005**

# Key Concepts

- Gross Domestic Product (GDP)
  - The money value of all goods and services produced within the UK
  - Also known as GDP *at current prices*
- Real GDP
  - The volume of goods and services produced within the UK (GDP adjusted for changes in the price level)
  - Also known as GDP *at constant prices*
- Economic Growth
  - The rate of increase of real GDP

# What is Economic Growth?

- Economics growth is best defined as the long run expansion of an economy's productive potential
- The growth rate is also expressed as the percentage annual increase in a country's real GDP
- Short term economic growth
  - Uses up existing spare capacity / factor resources (i.e. associated with falling unemployment)
  - An increase in the rate of factor utilisation
  - Usually determined by the growth of aggregate demand (AD)

# Growth of real national income

- Consider this hypothetical example:
- The rate of growth of real national income depends on how fast money national income is growing compared to changes in the general price level (i.e. the rate of inflation)

Year	Inflation rate	Rate of growth of money national income	Rate of growth of real national income
2001	4%	2%	-2%
2002	3%	3.5%	+0.5%
2003	2%	4%	+2%
2004	1%	1%	zero

# Economic Growth in the Long Run

- Long term economic growth requires
  - An expansion of the supply (stock) of factor inputs (e.g. a rise in the labour supply)
  - Improvements in production technology
  - Increased factor productivity
- These changes can be illustrated by an outward shift of the PPF

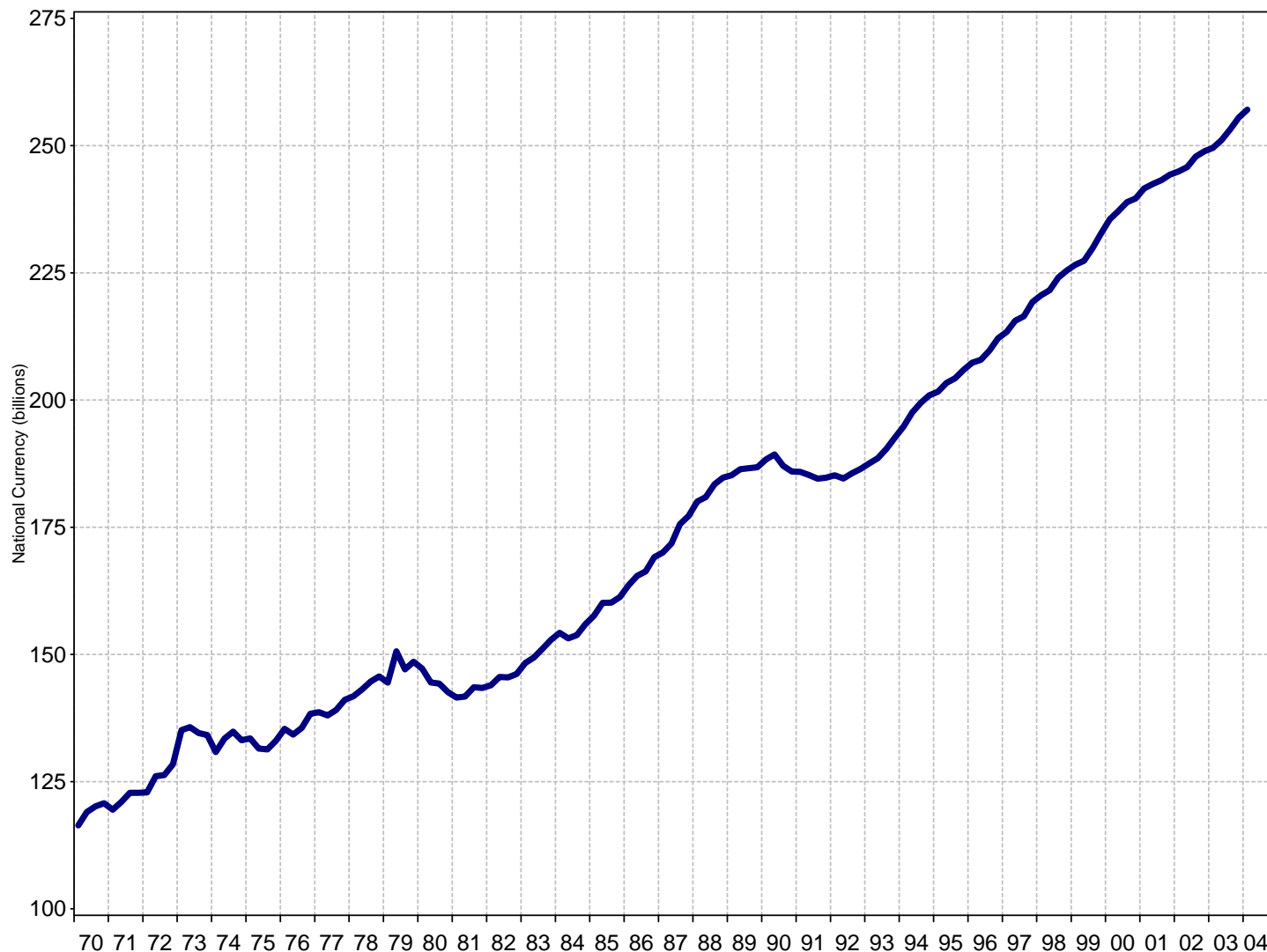
# Economic Growth – Historical Background

- The long run growth rate for UK over the last 30 years is 2.5% per year
- There have been three recessions in the last thirty years
- Sustained economic growth from autumn 1992 – 2004 – this is one of the longest periods of growth for many years
- The British economy has been one of the best performing countries within the European Union although other countries (including Spain, Estonia and Ireland) have achieved faster trend growth rates

# UK Economic Growth since 1970

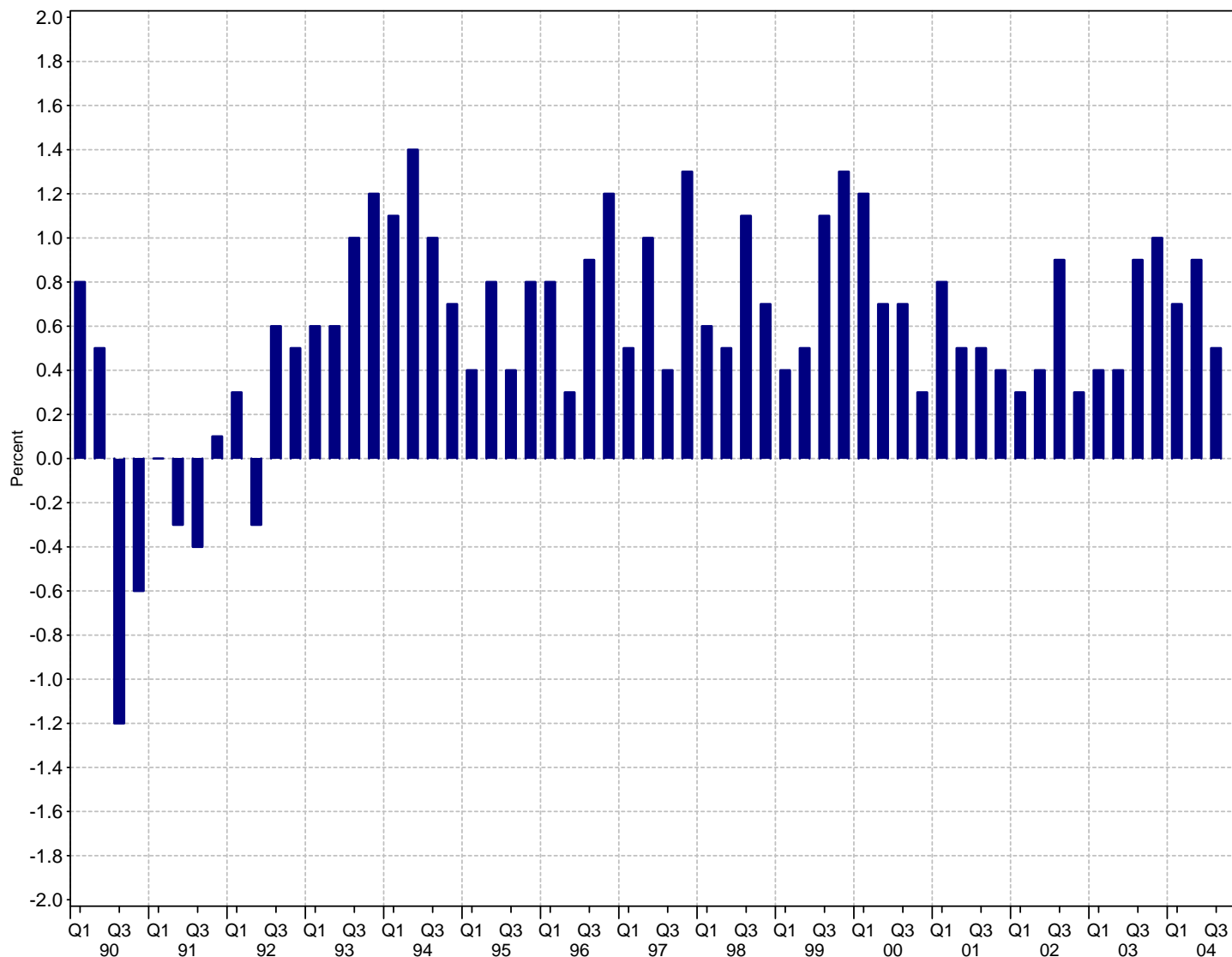
## United Kingdom, Long Run Growth of Real National Output

Value of GDP each quarter at constant 2000 prices



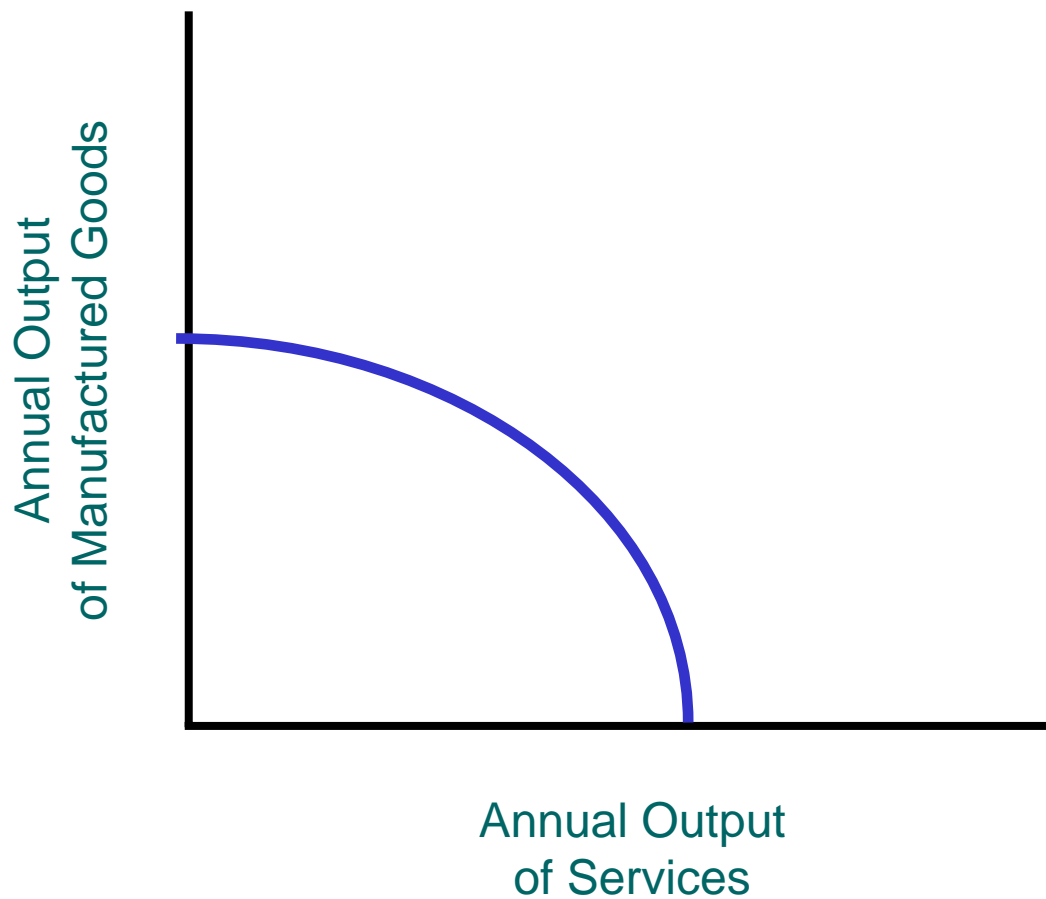
# Quarterly change in real national output

Real GDP Growth for the UK economy  
% change in real national output each quarter at constant prices

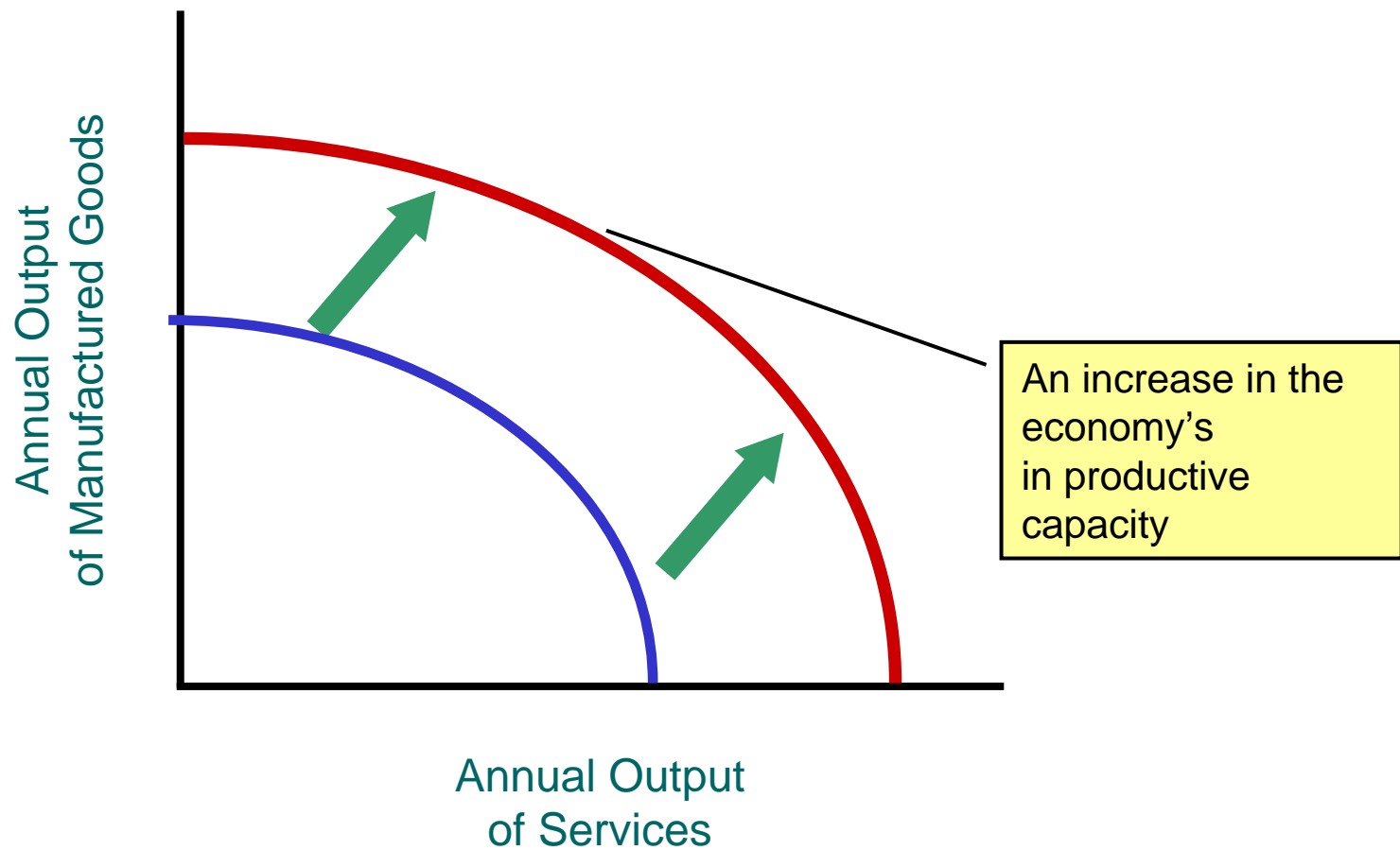




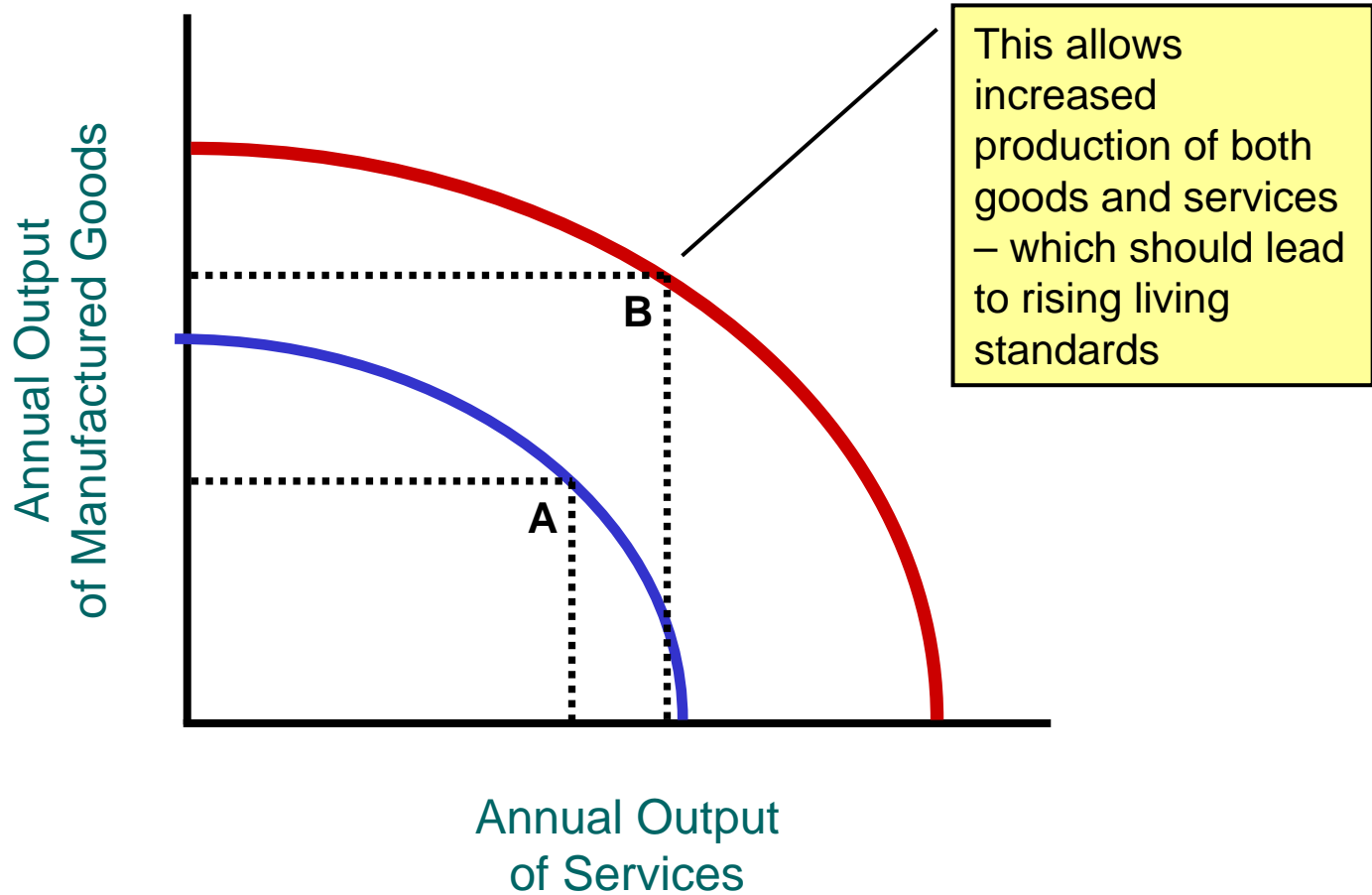
# Economic Growth and the PPF



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# Sources of Economic Growth (Changes in AD)

- Short Term Increases in AD
  - Higher consumer spending
  - Increased capital investment
    - Domestic investment
    - Inward investment from overseas
  - Rise in government spending on goods and services or a fall in government taxes
  - Increased exports sold to overseas countries
  - A reduction in import spending

# Sources of Economic Growth (Changes in AS)

- Supply-Side Explanations
  - Higher productivity (factor efficiency)
  - Increased supply of factor inputs
    - Expansion of employable labour supply
    - Increase in the stock of capital inputs
    - Exploitation of new finds of natural resources
  - Technological advances
    - Innovation and invention
    - Improvements in production process which reduce unit costs

# Determinants of Economic Growth

- Many factors influence the rate of economic growth. Some factors, such as changes in consumer and business confidence, aggregate demand conditions in the UK's trading partners, and monetary and fiscal policy, tend to have a mainly **temporary effect** on growth
- Other factors, such as the rates of population and productivity growth, have more enduring effects, and help to determine the economy's **average growth rate** over long periods of time.
  - Adapted from a Treasury paper

# The importance of innovation

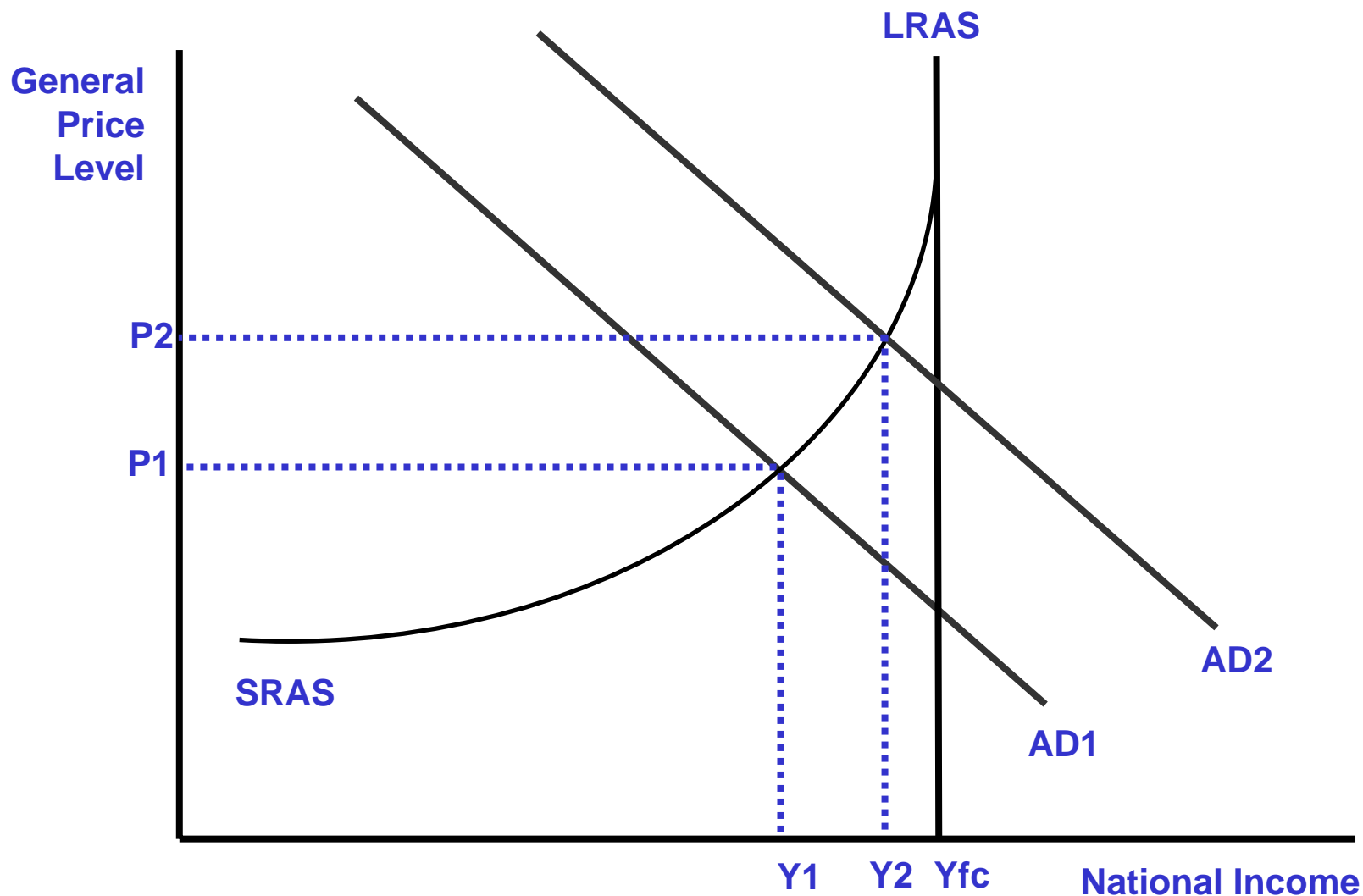
- **Innovation and Economic Growth**
- ‘A dynamic environment with opportunities for enterprise and innovation is vital to improving economic performance. New businesses entering the marketplace increase competitive pressures facilitating the introduction of new ideas and technologies. The Government is therefore committed to supporting enterprise and innovation throughout the economy, including in Britain’s most disadvantaged areas.’
- *Government Spending Review Statement, July 2002*

# Growth using AD-AS analysis

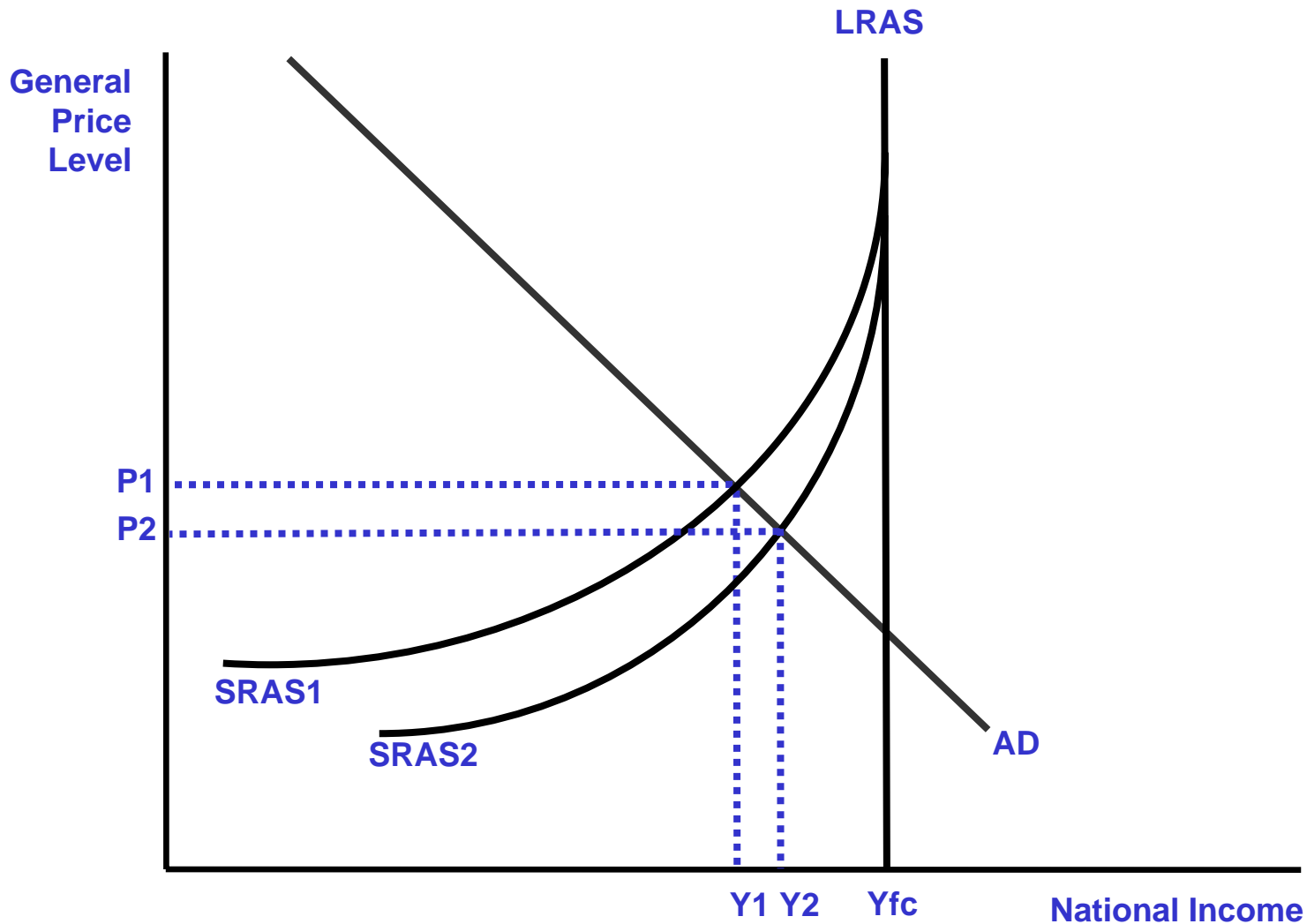
Aggregate demand and aggregate supply diagrams illustrating economic growth for an economy



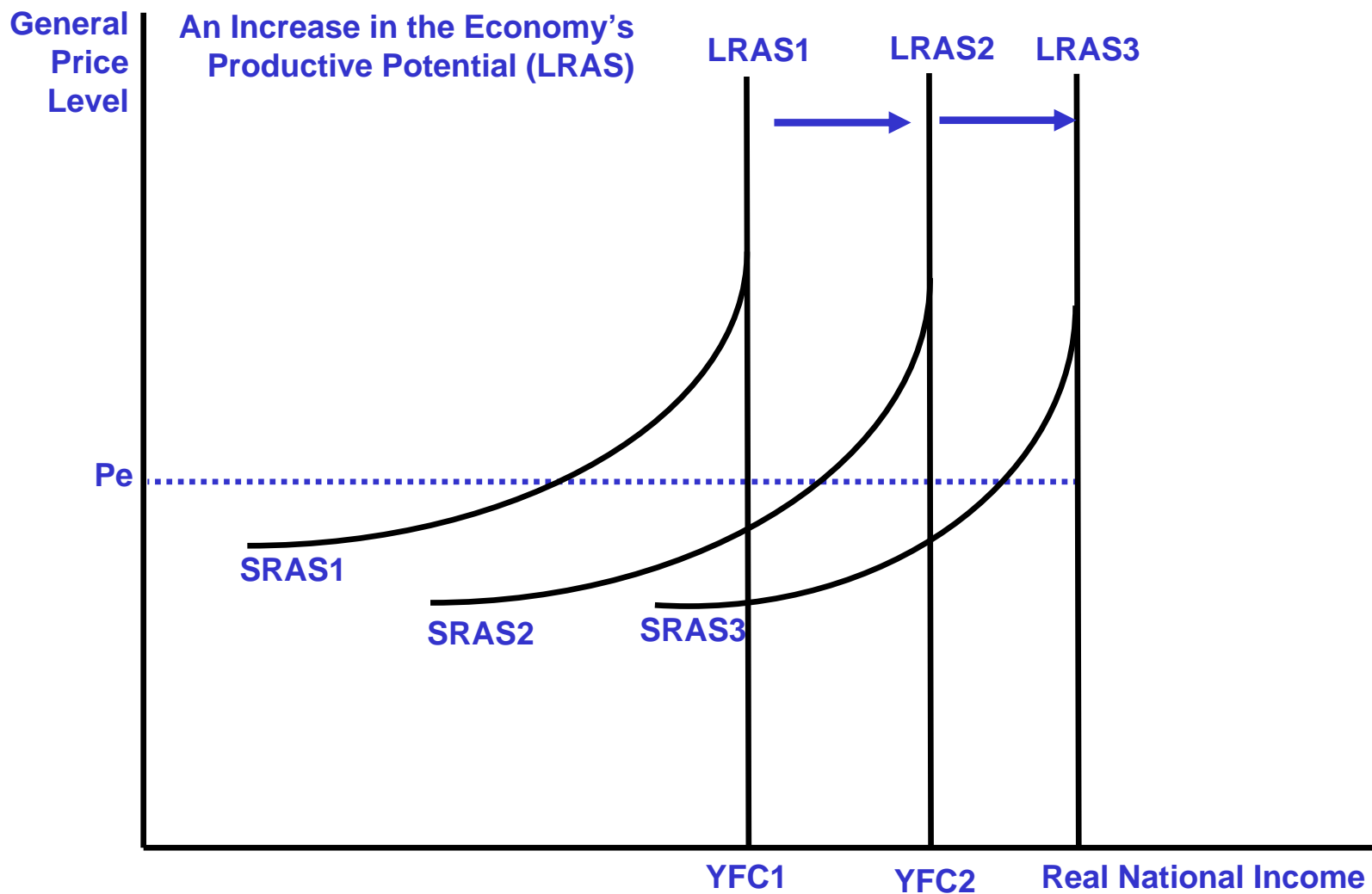
# Increasing Real National Output - Rising AD



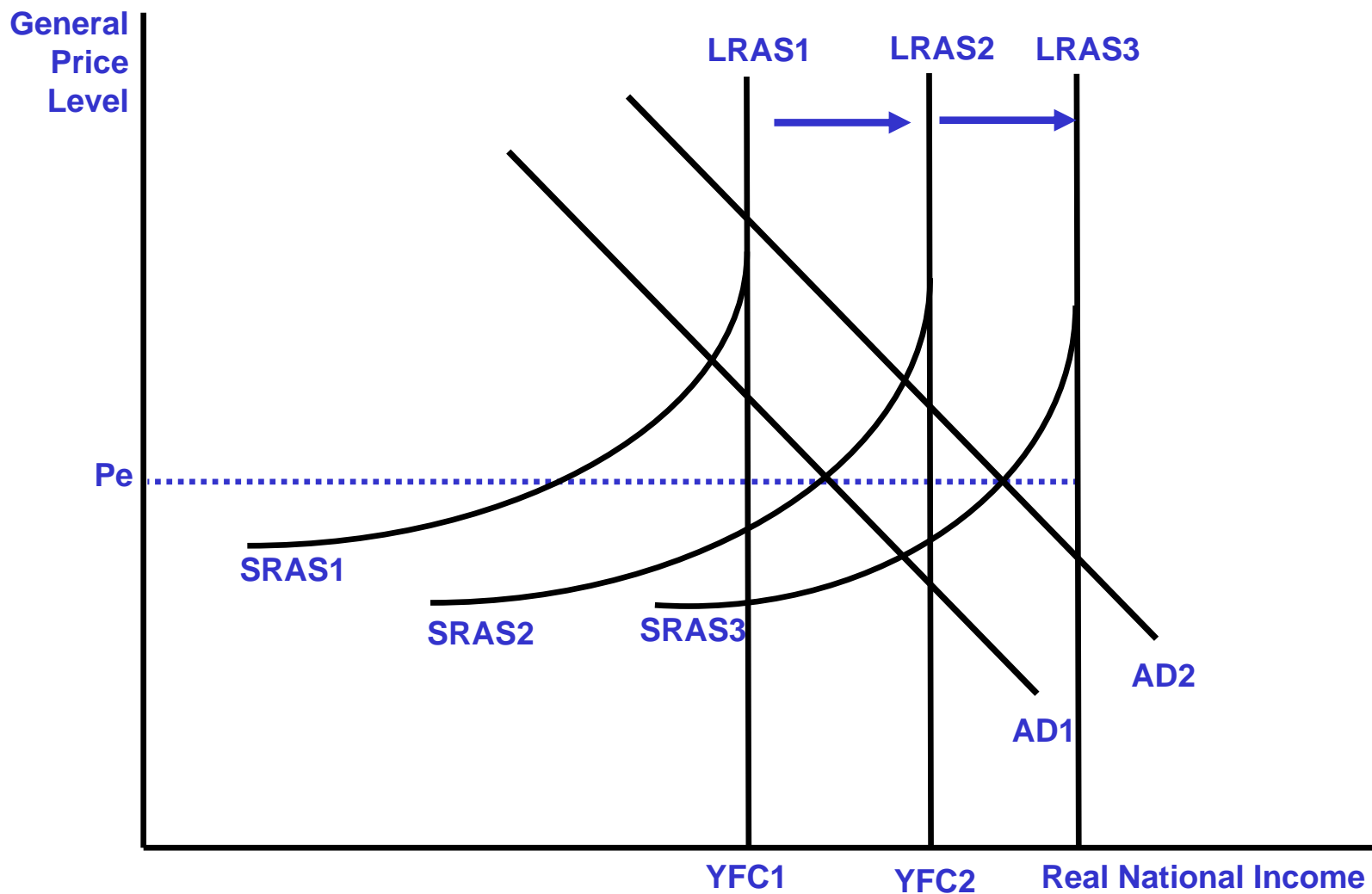
# Short Term Change in SRAS



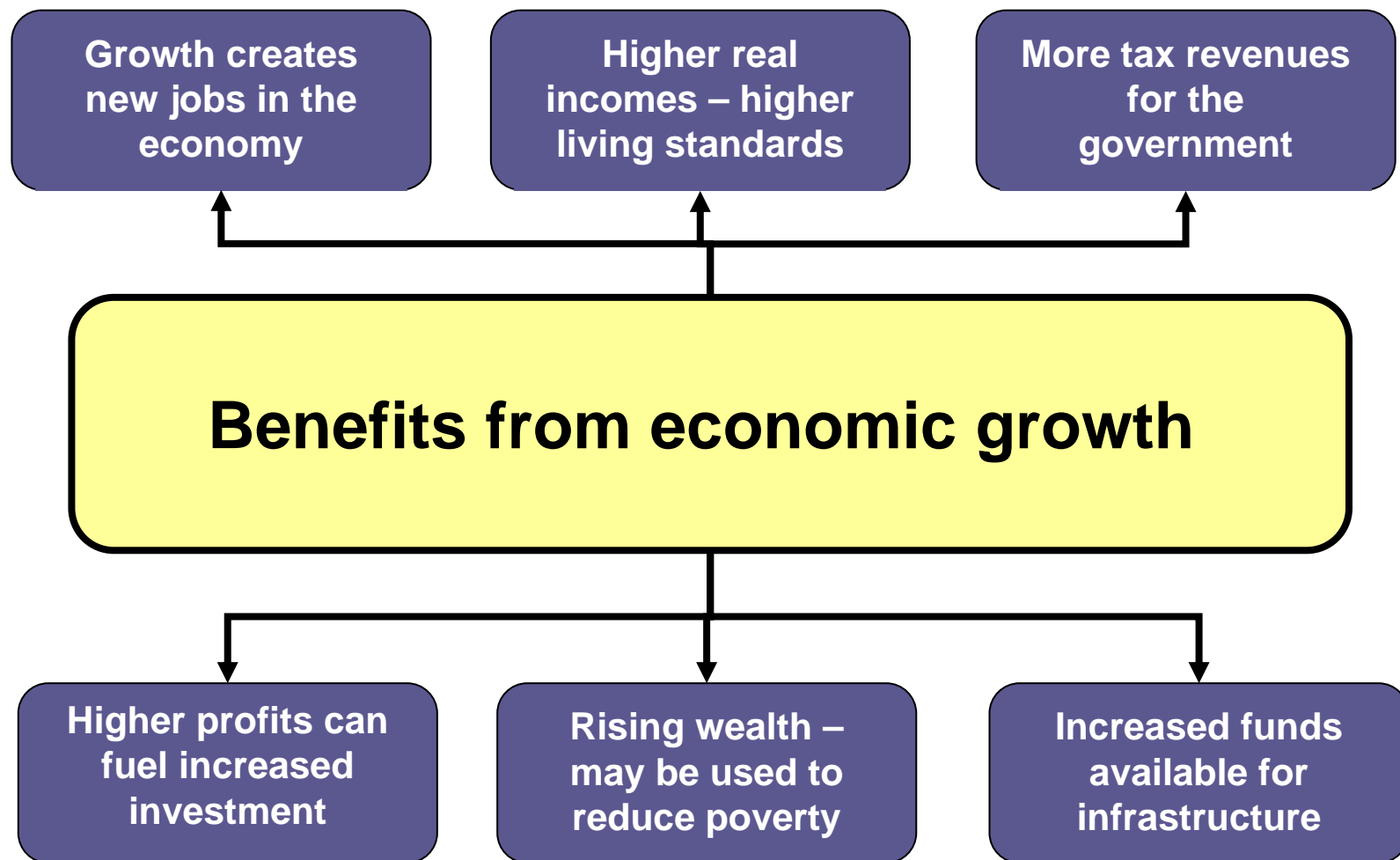
# An Increase in a Country's Productive Potential



# Higher AD and a rise in LRAS



# Benefits of economic growth



# Possible disadvantages of economic growth

