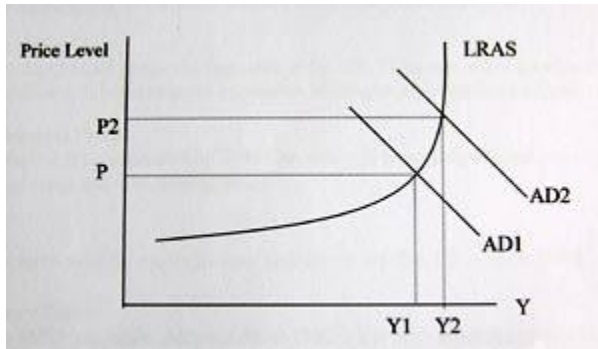


Causes of Economic Growth

1. Increase in AD

In the short term, economic growth is caused by an increase in AD. If there is spare capacity in the economy then an increase in AD will cause a higher level of Real GDP.



AD can increase for the following reasons.

- Lower interest rates – this reduces the cost of borrowing and so encourages spending and investment
- Increased wages. This increases disposable income and encourages consumer spending
- Increased Govt spending. G is a component of AD

Note: Classical Economists argue that an increase in AD will only increase Real GDP in the short term. They argue that the LRAS is inelastic therefore higher AD only causes inflation.

(Note: this is disputed by Keynesians. They believe the LRAS can be elastic, e.g. in a recession)

2. Long Term Economic Growth.

This requires an increase in the Long Run Aggregate Supply as well as AD.

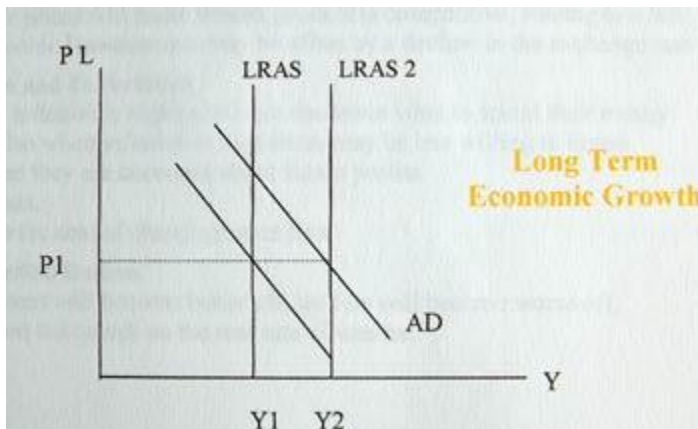


Diagram showing Long Term Economic Growth

LRAS or potential growth can increase for the following reasons

1. Increased Capital e.g. investment in new factories or investment in infrastructure such as roads and telephones.
2. Increase in working population
3. Increase in Labour productivity, through better education and training
4. Discovering new raw material
5. Technological improvements to improve the productivity of Capital and labour e.g. Microcomputers and the internet have both contributed to increased economic growth.
6. Re-allocation of resources

Does Economics Growth Bring Increased Living Standards?

Increasing the rates of economic growth has long been the holy grail of conventional economics and politics. To a large extent, most developed economies have been highly successful in increasing economic output. But, has such an impressive increase in national output actually improved people's standard of living?

To decide whether economic growth has increased happiness is highly subjective, and it is difficult for economists to make concrete arguments. However, it is worth noting the various side effects of growth and consider their impact on general living standards.

Benefits of Economic Growth

1. Increased consumption.

Consumers can benefit from consuming more goods and services. An assumption of economics is that consumption is related to utility, so in theory, with higher consumption levels, there is greater prosperity.

2. Improved Public Services.

With increased Tax Revenues the government can spend more on important public services such as health and education. Improved health care can improve quality of life through treating diseases and increasing life expectancy. Increased educational standards can give the population a greater diversity of skills and

literacy. This enables greater opportunity and freedom. Education is seen as an important determinant of welfare and happiness.

3. Reduced Unemployment and Poverty.

Economic Growth helps to reduce unemployment by creating jobs. This is significant because unemployment is a major source of social problems such as crime and alienation. However, despite rapid increases in economic growth since the Second World War, areas of high unemployment in the EU remain. For example, in France and Spain there are currently high levels of structural unemployment. This kind of unemployment may not be reduced by economic growth.

Why Economic Growth may not bring increased Happiness.

1. Diminishing Returns.

If a section of the population is living in absolute poverty, economic growth enables people to have higher incomes and therefore they will be able to afford the basic necessities of life such as; food, and shelter. When economic growth can overcome this type of poverty there is a clear link with improved living standards. However, when incomes increase from say \$35,000 a year to \$36,000 the improvement in living standards is harder to justify. Diminishing returns is a basic economic concept, which suggests the tenth unit of a good will give much less satisfaction than the first. If we already have 2 cars, do our living standards really improve if we now have the capacity to own 3 cars? Often as economic growth increases incomes, people increasingly save their money (higher marginal propensity to save) this is basically because they struggle to find anything meaningful to spend their money on.

2. Externalities of Growth.

Economic Growth with involves increased output causes external side effects, such, as increased pollution. Global warming from pollution is becoming a real problem for society. The economic and social costs could potentially be greater than all the perceived benefits of recent economic growth. However, it is worth noting that economic growth doesn't necessarily have to cause pollution. The benefits of growth could be used to develop better technologies that create less pollution. It is just at the moment this has been a low priority.

3. Economic Growth can cause Increased Inequality.

It is perhaps a paradox that higher economic growth can cause an increase in relative poverty. This is because those who benefit from growth are often the highly educated and those who own wealth. In 1980s and 1990s higher growth in the UK and US has resulted in increased inequality. (1) However, it depends on how growth is managed; economic growth can be used to reduce inequality. This occurred in 50s and 60s.

4. Increase in Crime and Social problems.

It is another paradox that as incomes increase and people are better off the level of crime has increased as well. (2) This suggests that crime is not motivated by poverty but perhaps envy. One reason why crime rates increase is that quite simply there are more things to steal. Back in the 1930s auto theft, mobile phone theft etc were rare or non-existent. Economic Growth has created more goods to steal. However the link isn't absolute for example in recent years crime rates in US have reduced from their peak. But there has been a general association between growth and crimes.

5. Higher Economic Growth has led to more hours worked.

In the beginning of the industrial revolution, higher growth led to people working lower hours.(3) However, in the past couple of decades higher incomes have actually led to people working longer hours. It seems people are unable to enjoy their higher incomes. Feeling the necessity or preferring to work longer hours. This suggest people are valuing earning money more than leisure. However, this trend may also be due to companies wanting people to work longer hours.

6. Depletion of Resources

Economic Growth increases economic activities; therefore, more resources are consumed up. Some of the resources are non-renewable, hence such resources are depleted quickly and in other word economy spends its future.