Lecture topic: The economic equilibrium and economic growth

Lecture outline:

Aggregate demand and aggregate supply. General economic equilibrium model.

Economic growth: essence, indicators. Economic growth factors.

Economic growth

- **Economic growth** is the increase in the amount of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in *real gross domestic product*, or *real GDP*. Growth is usually calculated in *real* terms, i.e. inflation-adjusted terms, in order to obviate the distorting effect of inflation on the price of the goods produced..

- In economics, "economic growth" or "economic growth theory" typically refers to growth of potential output, i.e., production at "full employment", which is caused by growth in aggregate demand or observed output

- As an area of study, *economic growth* is generally distinguished from *development economics*. The former is primarily the study of how countries can advance their economies. The latter is the study of the economic aspects of the development process in low-income countries.
- As economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure.

- **Measuring economic growth**
- Economic growth is measured as a percentage change in the Gross Domestic Product(GDP) or Gross National Product (GNP). These two measures, which are calculated slightly differently, total the amounts paid for the goods and services that a country produced. As an example of measuring economic growth, a country which creates $9,000,000,000 in goods and services in 2010 and then creates $9,090,000,000 in 2011, has a nominal economic growth rate of 1% for 2011.

Factors affecting economic growth

- There are several factors affecting economic growth, but it is helpful to split them up into:
- Demand side factors
- Supply side factors

Demand Side Factors Influence Growth of Aggregate Demand (AD)

- AD= C+I+G+X-M. Therefore a rise in Consumption, Investment, Government spending or exports can lead to higher AD and higher economic growth.

- **What Could Affect AD?**
- **Interest Rates**. Lower interest rates would make borrowing cheaper and should encourage firms to invest and consumers to spend. People with mortgages will have lower monthly mortgage payments so more disposable income to spend. However, recently we had a period of zero interest rates, but due to low confidence and reluctant banks growth was still sluggish.
- **Consumer Confidence**. Consumer and business confidence is very important for determining economic growth. If consumers are confident about the future they will be encouraged to borrow and spend. If they are pessimistic they will save and reduce spending.
- **Asset Prices.** Rising house prices create a positive wealth effect. People can remortgage against the rising value of their home and this encourages more consumer spending. House prices are an important factor in the UK, because so many people are homeowners.
- **Real Wages**. Recently, the UK has experienced a situation of falling real wages. Inflation has been higher than nominal wage, causing a decline in real incomes. In this situation, consumers will have to cut back on spending reducing their purchase of luxury items.

- **Levels of infrastructure**. Investment in roads, transport and communication can help firms reduce costs and expand production. Without necessary infrastructure it can be difficult for firms to be competitive in the international markets. This lack of infrastructure is often a factor holding back some developing economies.
- **Human Capital**. Human capital is the productivity of workers. This will be determined by levels of education, training and motivation. Increased labour productivity can help firms take on more sophisticated production processes and become more efficient.
- **Development of Technology**. In the long run development of new technology is a key factor in enabling improved productivity and higher economic growth.

- **Commodity Prices**. A rise in commodity prices such as a rise in oil prices can cause a shock to growth. It causes SRAS to shift to the left leading to higher inflation and lower growth. **Political Instability**. Political instability can provide a negative shock to growth. **Weather**. The exceptionally cold or hot weather, lead to a shock fall in GDP

Types of economic growth:

- There are 4 types of economic growth:
  1. Balanced Economic Growth
  2. Un-balanced Economic Growth
- 3. Extensive
- 4. Intensive

- 1.Balanced Economic Growth:
  All the economic sectors are growing at same ratio or percentage,this growth is known as balanced economic growth.
  2.Un-balanced Economic Growth:
  When some sectors of the economy are growing faster than others,and their rate of growth is different to each other,this growth is known as un-balanced economic growth.

- 3.Extensive Economic Growth:
  Economic growth is achieved by increasing number of production factors
- 4.Intensive Economic Growth:
  Economic growth is achieved by increasing quality of production factors, i.e. using of new quality raw materials, new technology and others

Literature list

- David Begg, Foundations of Economics, McGraw-Hill Higher Education, 2009.
- Andrew Gillespie, Foundations of Economics, OUP Oxford, 2011.
- Principles of Economics, Karl E. Case, Ray C. Fair, Sharon Oster, Pearson Higher Education, 2011.