ECONOMIC GROWTH AND ECONOMIC DEVELOPMENT

Difference between Growth and Development:

- What is the difference between growth and development?
- Can a country experience economic growth without development?

Gross Domestic Product (GDP) is the sum total of all final goods and services produced within a country for the market in a financial year.

Thus GDP is a measure of the National Income/ National Output and National Expenditure.

Economic Growth measures an increase in the Real GDP.

Economic Development on the other hand looks at a wider range of statistics than just GDP per capita, like measures of literacy, life-expectancy and health care.

Development is concerned with how people are actually affected and it looks at their actual living standards and the freedom they have to enjoy a good standard of living.

We would generally expect economic growth to enable more economic development. Higher real GDP enables more to be spent on health care, education and well-being of the people.

However, the link is not guaranteed. The proceeds of economic growth could be wasted or retained by a small wealthy elite.

Some measures economic development looks at are:

- Real income per head – GDP per capita
- Levels of literacy and education standards
- Levels of healthcare (e.g. number of doctors per 1000 population, infant mortality rate, maternal mortality rate)
- Quality and availability of housing and sanitation facility
- Levels of environmental standards
- Life expectancy
- Gender parity
- Corruption and Security
- Happiness and general well-being

But measuring economic development is not as precise as measuring GDP because it depends on what factors are included in the measure.

Economic Growth without Economic Development:

- **Absolute Poverty:**

  Economic growth may be essential to enable higher incomes for people to be able to buy more food. However, economic growth doesn't necessarily improve everyone's living standards. Economic growth could bypass the poorest sections of society because they don't have the ability to take part. A key issue is whether the benefits of economic growth are equitably distributed amongst different groups of society.

- **Education standards:**

  Economic growth may enable more money to be spent on education. However, there is no guarantee that the proceeds of growth will be used to improve education standards. There is often a weak correlation between GDP and literacy rates.

- **Environmental standards.**

  Economic growth can actually harm the environment and people's living standards. For example, higher output could cause more pollution. If higher growth involves cutting down forests – this could have adverse environmental consequences in long-term.

- **Transport / Infrastructure:**

  Economic development would require improvements in infrastructure and transport. This may be important for regions which may be cut off from the main areas of economic growth.

It is possible to have economic growth without development. i.e. an increase in GDP, but most people don't see any actual improvements in living standards. This could occur due to:

- **Inequality:**

  Economic growth may only benefit a small % of the population. For example, if a country produces more oil, it will see an increase in GDP. However, it is possible, that this oil is only owned by one firm, and therefore, the average worker doesn't really benefit.

- **Corruption:**

  A country may see higher GDP, but the benefits of growth may be syphoned into the bank accounts of politicians

- **Environmental problems.:**

  Producing toxic chemicals will lead to an increase in real GDP. However, without proper regulation, it can also lead to environmental and health problems. This is an example of where growth leads to a decline in living standards for many.

- **Congestion:**

  Economic growth can cause an increase in congestion. This means people will spend longer in traffic jams. GDP may increase but they have lower living standards because they spend more time in traffic jams.

- **Production not consumed:**

  If a state-owned industry increases output, this is reflected in an increase in GDP. However, if the output is not used by anyone then it causes no actual increase in living standards.

- **Military spending:**

  A country may increase GDP by spending more on military goods. However, if this is at the expense of health care and education it can lead to lower living standards.

Evaluation

It depends on the nature of economic growth.

- Higher GDP means an increase in National Output and National Income but it doesn't necessarily lead to visible economic development for the following reasons:
- It takes time for improvements in statistics like education and literacy rates. Higher GDP can be used to increase spending on education. But, it will take many years before education standards actually improve. Other types of investment like infrastructure and health care will also take a long time
- Higher GDP may not 'trickle down' to the rest of society. Often increased GDP tends to benefit a small section of society. This problem is worse if corruption is a serious problem
- If Higher GDP causes environmental problems, living standards can seem to worsen, rather than improve.
- It depends on how the proceeds of Growth are used. There is no guarantee that the proceeds of growth will be used in areas which benefit economic development like education and infrastructure. If GDP is used for military spending or debt repayments, there may be little improvement in overall improvement in standard of living.

Factors affecting Economic Growth in developing countries:

- Levels of infrastructure – e.g. transport and communication
- Levels of corruption – e.g. what percentage of tax rates are actually collected and spent on public services.
- Educational standards and labour productivity. Basic levels of literacy and education can determine the productivity of the workforce.
- Levels of inward investment. For example, China has invested in many African countries to help export raw materials, that its economy needs.
- Labour mobility. Is labour able to move from relatively unproductive agriculture to more productive manufacturing?
- The flow of foreign aid and investment. Targeted aid, can help improve infrastructure and living standards.
- Level of savings and investment. Higher savings can fund more investment, helping economic growth.

Difficulties in measuring living standards:

Purchasing Power Parity -

The most common method for measuring living standards is using GDP per capita. This is national income divided by population and gives a rough guide to average incomes. High real GDP per capita indicates citizens are able to purchase more goods and services

When comparing living standards between different countries, it is important to take into account different purchasing power parity's (PPP) – GDP per capita in $ terms does not necessarily reflect the local purchasing power of a country. For example, in Namibia incomes may be quite low – say $1,000 per capita. However, living costs are likely to be much lower in Namibia than say the US. With $1,000 you can buy a lot more in Namibia than in the UK or US. Therefore, it is important to take these factors into consideration when comparing living standards between countries

If we use GDP per capita in purchasing power parity (PPP) then income differentials are smaller.

Economic activity not measured –

Some countries may have large 'black market' or economic activity that isn't measured by official statistics. For example, in a country like Namibia, there is likely to be a significant degree of subsistence farming. This makes zero contribution to GDP statistics because nothing is officially produced, but people may have decent living standards.

Externalities of growth –

Higher GDP suggests higher living standards, but higher economic growth may be at the cost of increased pollution and congestion. This leads to a decline in living standards (poor health from pollution, time wasted from congestion) therefore GDP overestimates living standards. This has been an issue for countries like China – whose breakneck economic growth has been at the expense of pollution.

Hours worked –

Two countries may have similar GDP, but if one country has an average hourly week of 60 hours worked, this suggests lower living standards than a country which has an average of only 40 hours per week.

Poverty –

Living standards need to take into account how income and expenditure are distributed through society. A country may have high GDP per capita but still have significant poverty.

Intangibles –

Living standards are not just about consumption of goods and services. Arguably a key factor in living standards is issues such as a degree of individual liberty/democracy and freedom. This becomes difficult to quantify from an economic perspective.

Literacy –

Access to education is considered an important aspect of living standards. Without education, people will struggle to obtain their potential and their human capital will be lower. Education can also improve living standards in non-monetary ways – enjoying a greater degree of culture

What do we mean by living standards?

Some may think of living standards through financial measures. Others may place less emphasis on this and focus on issues such as the environment, 'general well-being' and levels of happiness.

Causes of economic growth:

Economic growth is caused by two main factors:

- An increase in aggregate demand (AD)
- An increase in aggregate supply (productive capacity)

Demand-side causes -

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

AD= C + I + G + X- M

C= Consumer spending

I = Investment (gross fixed capital investment)

G = Government spending

X = Exports

M = Imports

Factors which affect AD –

- **Lower interest rates** – Lower interest rates reduce the cost of borrowing and so encourages consumer spending and firms to invest. Lower interest rates also reduce mortgage payments and so increase the disposable income of consumers.
- **Increased wages**. Higher real wages increase disposable income and encourage consumer spending.
- **Increased government spending** (G). e.g. government investment on building new roads or increased spending on welfare benefits, which increase disposable income.
- **Devaluation.** A fall in the value of the exchange rate (e.g. Pound Sterling) makes exports cheaper and increases the quantity of exports (X). A depreciation also makes imports more expensive, reducing quantity of imports and making domestic goods relatively more attractive.

- **Confidence**. Increased consumer confidence encourages households to spend by either running down savings or taking out more personal credit. It enables higher spending (C)., which encourages spending (C).
- **Lower tax**. Lower income tax will increase the disposable income of consumers and increases consumer spending (C).
- **Rising house prices.** A rise in the price of houses creates a positive wealth effect. Homeowners who see a rise in the value of their houses will be more willing to spend (remortgaging house if necessary)
- **Financial stability**. If there is financial stability and banks are willing to lend, then firms will be more willing to invest and investment will increase aggregate demand.

Long-term economic growth –

This requires an increase in the long-run aggregate supply (productive capacity) as well as AD.

Long Run Aggregate Supply (LRAS) or potential growth can increase for the following reasons:

- **Increased capital**. e.g. investment in new factories or investment in infrastructure, such as roads and telephones.
- **Increase in working population**, e.g. through immigration, higher birth rate.
- **Increase in labour productivity**, through better education and training or improved technology.
- **Discovering new raw materials**. For example, finding oil reserves will increase national output

- **Technological improvements** to improve the productivity of capital and labour e.g. Microcomputers and the internet have both contributed to increased economic growth. In the future, economic growth may come from new technology such as Artificial intelligence (AI) which enables robots to take the place of human workers.

Other factors affecting economic growth –

- **Economic and political stability**:

  Stability is important for reassuring firms it is a good idea to invest in increasing capacity. If we see a rise in uncertainty, confidence tends to fall and this can cause firms to delay investment.

- **Low inflation:**

  Low inflation is a good climate for encouraging business investment. High inflation increases volatility.

Effects of Economic Growth:

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 there 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.

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 Rs.85,000 a year to Rs.90,000 the improvement in living standards is harder to justify. The diminishing marginal utility of income and wealth 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 the 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, for example, the economic growth which occurred in the 50s and 60s helped reduce inequality.

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 e.t.c 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 the 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 suggests people are valuing earning money more than leisure. However, this trend may also be due to companies wanting people to work longer hours.

6. Diseases of affluence

Economic Growth has enabled improved healthcare treatments, but at the same time, there has been an unexpected rise in the number of diseases and illnesses related to increased prosperity.(4) One example is obesity. Modern lifestyles and modern diets have created an epidemic of obesity, with significant proportions of the population expressing a desire to lose weight. It could be argued that problems such as obesity and stress-related illnesses are not a direct consequence of growth. This is true, but, it is symbolic of the fact increased prosperity has created as many new problems as it has solved

Conclusion:

There are clearly some benefits of economic growth. These benefits are most visible for low-income countries.

Economic growth enables the possibility to deal with many serious problems of poverty, homelessness and lack of basic amenities.

However, we are more interested in whether economic growth in developed economies is actually increasing living standards. Does rising incomes equal rising satisfaction? The answer is not clear-cut.

The challenge is to harness the potential of economic growth to make sure it really does increase sustainable living standards.