**Economics Notes – Aims of Government**

**Part 1 – Output & Economic Growth**

Definition of economic growth

Economic growth refers to the growth of the production, seen in terms of the actual or potential production capacity.

Actual Economic Growth

* Actual economic growth refers to the actualization of resources into monetized products and services, measured in term of the percentage change in real GDP.
* Actual economic growth is the percentage annual increase in national output actually produced that is the percentage change in the Gross National Product/Gross Domestic Product over the previous year.

Potential Economic Growth

Potential growth refers to the expansion of the availability of resources for production, measured in term of rightward shift of the long run supply curve and the outward shift of the production possibility curve (PPC).

Nominal Gross Domestic Product

The monetary value of all final goods and services produced **within a country** within a given period of time, expressed in current price level before corrected for inflation.

Real Gross Domestic Product

* + - The real value of all final goods and services produced **within a country** within a given period of time, expressed in base year price level after it is corrected for inflation.
    - Formula:

Real GDP = Nominal GDP x

Base Year Price Index

Current Year Price Index

Recession

A recession refers to the fall in real GDP for two consecutive quarters

Human Development Index

* HDI is a form of measurement of the standard of living in a country. It is measured in terms of the progress of well-being of individuals.
* The indicators that are used include infant mortality rate, life expectancy at birth, real per capita income (GDP per head) and literacy rate.

Real per capita income

* Real income of an individual in an ecnomy
* Formula:

Real per capita income =

Real GDP/GNP

Population figure

Factors Contributing to Economic Growth

1. **Physical Capital**
   * + Physical capital refers to the tangible investment goods like plant, equipment, machinery and building.
     + Physical capital accumulation increases the productivity of labour. Machines allow one worker to raise productivity and allow more efficient use of the limited natural resources such as land and raw materials.
2. **Labour Force**

* The labour force contributes to the growth of national income
* The quantity of labour force can be increased through the increase in the working population, labour participation rate or import of more foreign workers
* Training and development of the workers and import of foreign talents raise the productivity of the workers, improving the quality of labour force.

1. **Land and Raw Materials**
   * + Availability of land space and raw materials determines the resource capacity, which affects the cost of production.
     + Better management and utilization of resources will minimise the cost of resources which will determine the cost of production.

* E.g. Constructing taller buildings – enable greater utilisation of land capacity
  + - Higher cost of production will undermine the economy from attaining a higher level of national income and thus lowering actual economic growth
    - The shortage in the supply of resources will also reduce the resources capacity and thus undermines potential growth and this is usually overcome by the import of resources as seen in the case of Singapore

1. **Entrepreneurship**

* Entrepreneurs’ skills are essential in the organization of production.
* The effectiveness and efficiency of the entrepreneur will determine the productivity of the production and distribution process which will affect the production capacity of the economy, in actual and potential growth.

1. **Technological Advancement** 
   * + Technological advancement improves the efficiency of production, thus raising output and economic growth
     + Technological improvement includes the following:

* Innovation is the application of current and new knowledge in the production of goods and services
* For instance, new methods of production of automobiles that are more cost-saving would lower the cost of production and increase the output per worker
* Technological advancement also increases the quality of production and competitive edge, which will raise the efficiency of production contributing to lower cost of production

1. **Other Factors**

* Favourable cultural, social and political environment
* Law and order to sustain peace and stability in the country
* Cultural attitudes are important in shaping the incentives to work
* State ideology, such as meritocracy in Singapore, also affects the social mobility
* Sustained stability would promote investor confidence, thus leading to influx of investment, which generates economic growth

Positive Impacts of Economic Growth

1. **Higher standard of living**
   * + The main benefit of growth is the increase in amount of goods and service which becomes available for the country’s citizens to enjoy.
     + Economic growth also increases the income of the country allowing citizens to enjoy more of both local and foreign goods. (Raise GDP – Increase in real GDP as long as percentage increase in GDP is greater than percentage increase in price level and population growth)
     + Provides more tax revenue for the government to improve the infrastructures that will raise the convenience and comfort of the citizens
     + Also, higher standard of living can be seen in terms of higher literacy rates and lower mortality rate (death rates)
2. **More even distribution of income**

With more overall income available, government will have the resources to redistribute wealth the poor.

1. **Inflow of investment**

A stable level of economic growth increases firms and consumer confidence which will induce an accelerator effect on the economy. This will encourage more investment which, in turn, induces positive cycle of economic growth.

1. **Higher degree of employment**

Higher level of economic growth will mean a higher level of production, leading to greater labour demand. This is especially significant for a country with large population where growth in the labour intensive industries will produce more employment opportunities for the massive population. (E.g. China, India)

1. **Greater environmental sustainability** 
   * + As people grow richer, they satisfy their basic needs in life and have attained a certain material standard of living.
     + They move on to achieve more the qualitative side of life, becoming concerned about living in a clean environment.

* Growth also allows more resources to be used for the correction or regulation to reduce external costs.

Detrimental Impacts of Economic Growth

1. **Opportunity Costs of Economic Growth**

* To achieve higher economic growth, opportunity cost of higher consumption in the current time period is incurred.
* Firms have to invest more and require financing, so as to raise production
* The finance can come from higher savings or taxes, thus implying that there is a cut in current consumption, which will lower the standard of living in the short run

1. **Structural Unemployment**

* The pursuit of higher economic growth will create greater focus on high-valued industries, such as tourism, to raise the competitiveness of the economy
* As such, there will be technological changes and sectoral adjustments, leading to the mismatch of skills and rise in structural unemployment as some industries rely more on machinery than human labour

1. **Inflation**

* Higher economic growth will lead to higher demand for resources, which will raise the cost of resources, resulting in cost-push inflation
* Also, economic growth will lead to higher level of disposable income, resulting in higher consumption, thus the onset of demand-pull inflation

1. **Uneven Distribution of Income**
   * + Higher economic growth will benefit individuals who are able to adapt to the changing patterns of demand and supply conditions
     + The more skilful individuals will benefit more from higher economic growth as compared to the less skilled individuals

* For example, there is wage inequality for skilled and less skilled workers in a capital-intensive industry
  + - Consequently, there is a widening income inequality, which leads to greater social discontentment that hinders social stability

1. **Depletion of non-renewable resources** 
   * + Higher growth implies higher production, which means that there is greater demand for resources
     + Consequently, greater utilization of resources, particularly non-renewables, will lead to the depletion of resources
     + For instance, coal and oil are non-renewable
2. **Increase in negative externalities**

* Higher output and consumption would place greater pressure on the environment
* Hence, this leads to greater environmental pollution, such as the emission of greenhouse gases that accelerates the effects of global warming

1. **Health-related issues**

* The sustained pursuit of economic growth may lead to higher stress levels
* For instance, workers are required to frequently upgrade existing or acquire new skills, so as to stay relevant in the industries
* Furthermore, economic growth may lead to longer working hours
* Consequently, there may be higher health issues and the fall in productivity
* As such, despite higher living standards, the individuals may rank low on the Happiness Index, seen in developed countries like Japan

Policies to achieve higher economic growth

1. **Expansionary Monetary Policy**
2. **Expansionary Fiscal Policy**
3. **Supply-side Policy**
4. **Infrastructural Development**
5. **Manpower Development**
6. **Trade Policies**
7. **Direct Regulation – Keep wage increments at reasonable level**

**Questions for discussion:**

**1. Some developing economies are unable to achieve high economic growth rate and it will create devastating impact on the economy.**

a) What is the main difference between short-term growth and long-term growth. (4)

b) Using the production possibility curve, explain how actual and potential growth is achieved with the import of more resources. (6)

c) Give two reasons why some countries achieve high growth rate while other countries achieve low growth rate. (6)

d) What is meant by recession? Why countries fall into recession? (4)