Topic Page: Economic growth

Definition: **economic growth** from *QFinance: The Ultimate Resource*

increase in country's economic activity and income an increase in the national income of a country created by the long-term productive potential of its economy

Summary Article: **Economic Growth**
From *Encyclopedia of Business Ethics and Society*

Economic growth is most commonly defined as the rate of increase in the value of a country's output over a period of time. It is often presumed that economic growth is necessary and valuable to a society because it is accompanied by an improved quality of life for that society's citizens. For example, increased economic growth may allow a society to become better educated. As a result, more effective medical systems will be developed that allow for healthier lifestyles within that society. In this example, societal gains are achieved from both fiscal and health perspectives.

Thoughts About Economic Growth: Then and Now

As a means of gaining a more comprehensive understanding of economic growth, it is instructive to look at the theories of some of the topic's thought leaders over time. This perspective will make it easier to understand the wide array of successful and unsuccessful economic development or growth policies used by various government entities. Although ancient Greeks and Romans demonstrated an understanding of economic security and growth as the foundation for social and political health, most of the discussion about the topic has occurred in the last 250 to 300 years.

Some of the economic writings from the 16th through the 18th centuries dealt with the growth of commerce resulting from European expansion. The Mercantilists sought limitations to trade between countries while expanding their own contiguous territorial or colonial trading systems. On the other hand, one of the most highly regarded anti-Mercantilists was David Hume, who wrote *Political Discourses* in 1752. Hume argued that international trade is not a zero-sum game and that the growth of international trade was directly related to the strength and diversity of the trading partners. Today, the viewpoints of both the Mercantilists and Hume are endorsed by political leaders as they struggle to achieve economic growth in a global economy.

One of Hume's contemporaries, Adam Smith, provided additional thoughts about economic growth when he published *An Inquiry Into the Nature and Causes of the Wealth of Nations* in 1776. Smith's premise was that the self-interest of individuals drives them to compete. This competition will in turn result in the production of goods and services that society wants, in the amounts that it wants, and at appropriate prices.

In other words, it was Smith's belief that an evolving capitalist system, driven by economic growth, would benefit society as a whole. More than 200 years later, Smith's beliefs about growth benefiting society were highlighted in a series of articles in *The Economist* in 2005. The discussion cited examples of how economic growth had improved people's lives, with the production of ample food supplies, the provision of adequate housing, the facility to travel freely, and a sharp reduction in chronic diseases.

In 1798, Thomas Malthus prepared *An Essay on the Principle of Population.* In this writing, he suggested that the population would grow at a geometric rate, while the food supply would only grow at an arithmetic rate. This writing was in direct conflict with a popular notion at that time that a productive society, or one that experienced growth, was a society that maintained a high fertility rate and ultimately a larger workforce. It was Malthus's belief that population growth would decrease output per worker, particularly in agriculture, thus reducing the standard of living. Malthus held the lower class responsible for this situation and suggested that the British government should establish restrictive policies to hold the middle and lower classes responsible for maintaining the proper rate of population growth. To a certain extent, his premise is followed today in certain countries, such as China, which has implemented a policy of one child per family.

In the early 19th century, David Ricardo added to the work of Malthus by suggesting that as economies grow, they will ultimately reach a point where the law of diminishing returns takes effect, forcing the economy to come to a standstill. Karl Marx built on some of these ideas in his criticism of capitalism. Marx and his followers challenged capitalism on social, moral, and economic fronts, pointing out the peaks and valleys of business cycles and the inherent exploitive tendencies of capital accumulation as weaknesses in the capitalistic economic system. Marx believed that communism was a preferable economic system to capitalism because it provided economic growth at a controlled rate, thus eliminating the human suffering associated with class conflict and sharp downturns or recessions. The Austrian economist Joseph Schumpeter offered a more positive assessment of economic turbulence within the capitalist system, arguing that economic growth and change arose from an entrepreneurial gale of creative destruction.

Finally, John Maynard Keynes should be acknowledged for his 1936 publication of *The General Theory of Employment, Interest, and Money.* Through his indepth analysis of business cycles, Keynes suggested that recessions could be eliminated and economic booms controlled through the selective use of government fiscal and monetary policy. While Marx and Keynes shared the viewpoint that the economy should have fewer peaks and valleys, their methods for accomplishing this goal had different real-world implications for society as a whole.

Determinants of Economic Growth

Economic growth is driven by a variety of factors. By definition, the primary determinants of growth are frequently classified as either factors of production or factors of supply and demand.

Factors of production include natural resources such as land, minerals, or other inputs. Most resources are limited and often scarce. This is in sharp contrast to the unlimited needs and wants of people. For example, countries in the Middle East are rich in oil, yet the long-term demand for petroleum products exceeds the supply of oil in the Middle East and other countries combined.

In addition, labor and human capital are factors of production. It should be noted that there is a portion of the goods and services produced by workers such as housewives or volunteers that is not recorded in the gross domestic product (GDP). A second factor for consideration is human capital, which is the quality of labor resources. Obviously, not all laborers are of the same quality. Their level of production can vary based on such factors as their education, age, training, experience, happiness, health, and family environment.

The final factor of production is capital. While capital can refer to the money used to run a business, it is more frequently thought of as the investment in “capital goods” that can be used to generate other goods. In other words, computers, machinery, and other equipment are purchased and placed in buildings for the creation of specific products, such as automobiles, televisions, and cellular phones. The factors of supply and demand relate to the range of prices and quantities of the resources, the capital goods, and the trained workforce that is available for use in the production process.

It is also necessary to acknowledge the role that technology and technological advancements play in economic growth. While there is no doubt that technology played a major role in economic growth and productivity gains during the late 20th century and early 21st century, there does not seem to be a consensus about how technology should be included as a determinant of growth.

The combination of increased affluence, desires for instant gratification, technological advancements, and growing concerns about built-in obsolescence within a disposable society has altered the demand for goods and services in the more affluent parts of the world. To some extent, desires for a cleaner and safer environment and higher quality of life are being factored into growth expectations. As a result, the factors of production are being looked at more closely, and alternate methods of evaluating economic growth are evolving.

More About GDP Growth

As mentioned previously, the most common measure of economic activity is the GDP. This rate of change in the value of goods and services produced within a country is typically calculated on a quarterly or annual basis. It is also possible to look at real GDP growth, or the change in the value of production with the effect of inflation factored out. The real GDP per capita is useful for comparing economies of different sizes because it provides a measurement of how much each person produces during a designated period. It is calculated by dividing the real GDP by the size of the population. Potential GDP growth is the optimal rate at which an economy should grow. Finally, gross national product reflects the value of goods and services produced by an economy, regardless of where its citizens are located.

The following example describes economic growth in the United States. Table 1 shows U.S. economic growth by decade, based on changes in the GDP and real GDP. The data series, produced by the Bureau of Economic Analysis, was initiated in 1929. It can be seen that the periods of highest GDP growth for the eight periods occurred during the 1940s and 1970s. A closer look at the inflation-adjusted data shows that the decade of the 1970s was actually ranked fifth, below the overall average, with real GDP growth of only 3.2%. The lesson from this example is that it is often instructive to use more than one data set when evaluating economic growth.

Table 1 GDP Growth in the United States Between 1929 and 2005

Period	*GDP (%)*	*Real GDP (%)*
1929–1940	− 0.2	1.6
1941–1950	11.2	5.6
1951–1960	6.0	3.5
1961–1970	7.0	4.2
1971–1980	10.4	3.2
1981–1990	7.6	3.3
1991–2000	5.4	3.3
2001–2005	4.9	2.6
Overall	6.5	3.4
Source: Bureau of Economic Analysis.		

Other Measures of Economic Growth

A variety of economic growth measures are used at lower levels of government. At the state level, it is slightly more difficult to evaluate productivity. While the gross state product exists, it often has limited use because it is not published in as timely a fashion as its national counterpart and because commerce is not necessarily dictated by state boundary lines. As a result, it may be necessary to look at other measures or a combination of them to monitor changes. Other common means of measuring economic growth in a region or state are to evaluate changes in population, employment, unemployment rates, personal income, per capita income, annual average wages, and retail sales.

Many of these data sets are also available for evaluating geographic areas smaller than states, such as cities, counties, or special districts. In addition, some data sets evaluate economic characteristics specific to the local area. For example, tourism-based economies may focus on the number of hotel rooms occupied, average hotel room rate, rounds of golf played, or number of skier days. Communities that place an emphasis on intellectual capital may look at patents awarded, R&D expenditures, grants awarded, or the number of high school or college graduates. At the local level, factors such as traffic congestion, social service funding, quality of public schools, crime rates, housing affordability, public safety, and air quality are examples of indicators that measure social or environmental welfare associated with economic growth.

Economic Growth, Social Welfare, and Environmental Responsibility

Many discussions about the impact of economic growth automatically assume that the expansion of the economy is good for society and translates into a higher standard of living for the general public. This is an assumption that may not necessarily be true.

For example, during the first years of the new millennium, the business infrastructure of China improved. A review of data from the World Bank reports that the number of aircraft departures, telephone subscribers, and Internet users has risen dramatically. Growth in these and other areas has allowed China to experience real annual GDP growth of 8% to 10%, over twice the annual growth rate of the United States.

In some cases, China's rampant growth has imposed societal costs that have not been adequately addressed or measured. For example, increased energy and electric power consumption has been accompanied by greater pollution. Anecdotal evidence also suggests that growth has occurred without regard to workforce safety, employment security, and environmental sustainability. In addition, unemployment in China during the early 2000s was about 20%, compared with 6% in the United States. This example illustrates that increased productivity, or GDP growth, for an entire country does not necessarily translate into quality-of-life gains for society as a whole; nor does it ensure that the income gap between the rich and the poor is narrowed.

Consider another situation that occurred on June 23, 1969, in Cleveland. On that date, the Cuyahoga River caught fire for at least the third time in less than 30 years. The fire was caused by various forms of human and industrial waste dumped in the river by the city sewage plant and by chemical and petroleum companies that resided on its banks. In the short term, the city waste plant and companies along the riverbank achieved a high level of productivity and prosperity, factors favorably associated with economic growth. On the other hand, the societal and environmental impact of polluting the river to the point that it caught fire should be included in an assessment of the welfare benefits of economic growth.

These two examples suggest that there is value in having a broader, more balanced definition of economic growth. Such a definition might take into account the triple bottom line (measuring social and environmental as well as financial performance), economic stability, and sustainability. It would consider not only the production of goods and services but also any social or environmental impact brought about by their production and delivery throughout the world.

The genuine progress indicator (GPI) is offered by its developers, Venetoulis and Cobb, as a more accurate measure of economic growth than the GDP. This indicator evaluates both personal consumption and the well-being of households. The latter component attempts to measure the social costs associated with the labor force, such as crime, divorce, or loss of leisure time. It also considers the depreciation of the factors of production—in other words, the impact of growth on environmental assets and natural resources. Research conducted by the GPI developers shows that GDP economic growth is substantially greater than the GPI. In this case, pure economic growth is diminished by the impact of societal and environmental factors.

An expanded definition of economic growth could include measurement of efforts to maintain a balance between profits, the planet, and the people affected by the production of goods and services. It might also evaluate the give-and-take between companies within an economy and the members of society.

Finally, consideration could be given to the organization's integrity, transparency, and willingness to be held accountable for the social and environmental impact of its economic actions.

See also

Capitalism; Development Economics; Economic Incentives; Environmental Ethics; Federal Reserve System; Free Market; Gross Domestic Product (GDP); Gross National Product (GNP); Income Distribution; Invisible Hand; Marxism; Population Growth; Smith, Adam; Triple Bottom Line; U.S. Bureau of Economic Analysis; U.S. Bureau of the Census

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