



Growth Productivity Wealth of Nations
Part one

Laughter Curve

We have two classes of forecasters:
Those who don't know, and those who
don't know they don't know.

John Kenneth Galbraith

General Observations about Growth

- Growth increases the economy's potential output.

Growth and the Economy's Potential

- **Growth** is an increase in the amount of goods and services an economy produces.
- Growth is an increase in potential output.

Growth and the Economy's Potential

- **Potential output** – the highest amount of output an economy can produce from the existing production function and existing resources.
- When an economy is at its potential output, it is operating on its production possibility curve.

Growth and the Economy's Potential

- Long-run growth focuses on supply.
- It assumes **Say's Law** – supply creates its own demand.

Growth and the Economy's Potential

- In the short run, economists consider potential output fixed.
- They focus on how to get the economy operating at its potential if it is not.

Importance of Growth for Living Standards

- Growth improves living standards.
- It makes more goods available to more people.
- Because of compounding, long-term growth rates matter a lot.

Importance of Growth for Living Standards

- The Rule of 72 is used to determine how long it takes for income to double at different growth rates.
- The **Rule of 72** – the number of years it takes for a certain amount to double in value is equal to 72 divided by its annual rate of increase.

Markets, Specialization, and Growth

- Markets, specialization and the division of labor increase productivity and growth.
 - **Specialization** – the concentration of individuals on certain aspects of production
 - **Division of labor** – the splitting up of a task to allow for specialization of production.

Economic Growth, Distribution, and Markets

- Markets are often seen to be unfair because of the effect they have on the distribution of income.

Economic Growth, Distribution, and Markets

- Markets may not provide equality of income but they make the poor better off.
- There is strong evidence that the poor benefit enormously from the growth that markets foster.

Economic Growth, Distribution, and Markets

- Just because the poor benefit from growth does not mean they might not be better off if income were distributed more in their favor.

Per Capita Growth

- **Per capita output** is total output divided by total population.
- **Per capita growth** means producing more goods and services per person.

Per Capita Growth

- Per capita growth equals the percent change in output minus the percent change in population

Per capita growth =
 $\% \text{ change in output} - \% \text{ change in population}$

Per Capita Growth

- In many developing nations, the population is rising faster than GDP, resulting in a lower per capita growth rate.

Per Capita Growth

- Some economists have argued that per capita (mean) output is not what we should be focusing on.
- We should focus on median income instead.

Per Capita Growth

- Median income is a better measure because it takes into account how income is distributed.

Per Capita Growth

- If the growth in income goes mostly to a small minority of individuals, the mean will rise but the median will not.
- Because statistics on median income is generally not collected, economists use per capita income.

Cost of Goods in Hours of Work


