Consequences of economic growth & the balance between markets & intervention

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CONSEQUENCES OF ECONOMIC GROWTH

- If GDP rises faster than population, GDP per capita increases. Greater potential for people to increase consumption and standards of living.
- GDP per capita is only an average measure. Does not tell us the distribution of standards.
- Distribution of income – if income increases bypass the poorer people, growth has little developmental effects.
- The greater the share of household income spent on food, education, or health, the greater effect of human development.
- The greater the share of income controlled by women, the stronger the impact of human development.
- NGO contributions impact development because of their ability to reach poor people.
- This type of investment can affect human development.
- Appropriate policies are necessary to make effective use of resources.

Economic Growth And Unemployment

- Economic growth in the short-term business cycle fluctuations can reduce cyclical unemployment with a temporary effect on natural unemployment.
- Not all increases in potential output lower natural unemployment.
- Economic growth may lead to structural unemployment due to changes in technologies. Growth could result from inappropriate technologies.
- Long-term reductions in unemployment result from economic growth, but not all growth can lower unemployment.

Economic Growth And Inflation

- In the Keynesian model, price level remains constant in the expansionary phase because of spare capacity until the level of potential output. In the classical model, an AD increase will increase the price level.
- Both models agree that growth caused by increases in AD is inflationary around the level of potential output.

Economic Growth And Income Distribution

- No clear relationship between GDP per capita growth and income distribution. Some countries have highly unequal income distributions during growth, and other countries focus on development and equality.
- Inequalities arise from liberalization and loss of government protection.
- Income distribution can worsen due to:
    - capital-intensive technologies
    - low government investment
    - allocating services to urban places, not rural places
    - ignoring urban slums
    - Policies decide whether economic growth is good or bad for distribution.

Economic Growth And Current Account

- Short-term growth can lead to a larger current account deficit, because increasing incomes lead to demand for imports.
- During long-term economic growth, trade balance determined by:
    - international competitiveness (efficiency, etc.)
    - exchange rates
    - degree of export orientation
    - growth of incomes of trading partners (more exports)
    - degree of trade barriers
- Economic growth can lead to a larger deficit/smaller surplus in the upper phase of the business cycle, but over the long term, there is little likely growth.

Economic Growth And Sustainability

- Rapid growth leads to unsustainable resource use, such as use of common access resources.
- Growth can cause air pollution, soil degradation, etc.
- Negative consumption externalities.

- Belief that economic growth and sustainability are conflicting – “grow now, clean up later.”
    - Some environmental damage irreversible
    - Justifies government inaction on environment
    - Growth is not bad for the environment, but the method to pursue growth is.
    - Growth with unsustainable resource use may cause diminished growth in future
- Governments can pursue growth and sustainability with some conditions:
    - internalize the externalities and promote green tech
    - pursue environmental regulations
    - emphasize human capital
    - emphasis on green investments
    - Economic growth and sustainability can be pursued together.

Conclusion

- Living standards – economic growth can impact living standards, but it depends on the type of growth and what is improved.
- Unemployment – economic growth can lower cyclical unemployment, and can allow the government to use resources better.
- Inflation – economic growth can contribute to high levels of inflation. High levels of inflation may contribute to lower growth.
- Distribution of income – growth can make distribution of income more equitable. Equal distribution of income has a positive effect on growth.
- Current account – economic growth can worsen current account, but a deficit can lower economic growth.
- Sustainability – growth that ignores environmental effects may lead to unsustainability. Unsustainability leads to lower economic growth.
- It’s hard to know what to do because these factors affect economic growth and economic growth affects these factors.

BALANCE BETWEEN MARKETS & INTERVENTION

Strengths And Weaknesses Of Market-Oriented Policies

- Market-oriented policies include:
    - market-based supply-side policies: encouraging competition, labor market reforms, incentives
    - trade liberalization
    - freely floating rates
    - liberalized capital flows
- Strengths include:
    - prices work as signals and incentives
    - encouraging competition makes markets more competitive and results in greater efficiency
    - labor market reforms promote free market forces
    - trade liberalization makes markets larger
- Weakness include
    - market failure: externalities, public goods
    - lapses in coordination: Two activities that ought to begin simultaneously fail.
    - weak/missing market institutions: markets need some institutions to function properly
    - dualism: dual economies may form even if a country grows
    - income inequality
    - insufficient credit for poor people
    - may not always lead to growth and development

Strengths And Weaknesses Of Interventionist Policies

- Interventionist policies – based on intervention to make markets work efficiently
- Strengths include:

- correcting market failure
- investment and provision of infrastructure
- provision of stable macroeconomic environment
- provision of a social safety net, a system of government transfers to vulnerable groups redistribution of income
- industrial policies

- Weaknesses include:
  - excessive bureaucracy
  - bad planning
  - corruption

Market With Government Intervention

- Governance is the way power is used to manage a country's social and economic resources for development.
- Good governance principles:
  - participation, fairness, decency, accountability, transparency, efficiency
- Strong government intervention discredited as a strategy for growth, dev., and trade.
- Market-led dev. strategy doesn't account for circumstances in developing countries.
- Not good for a blanket approach of any sort.

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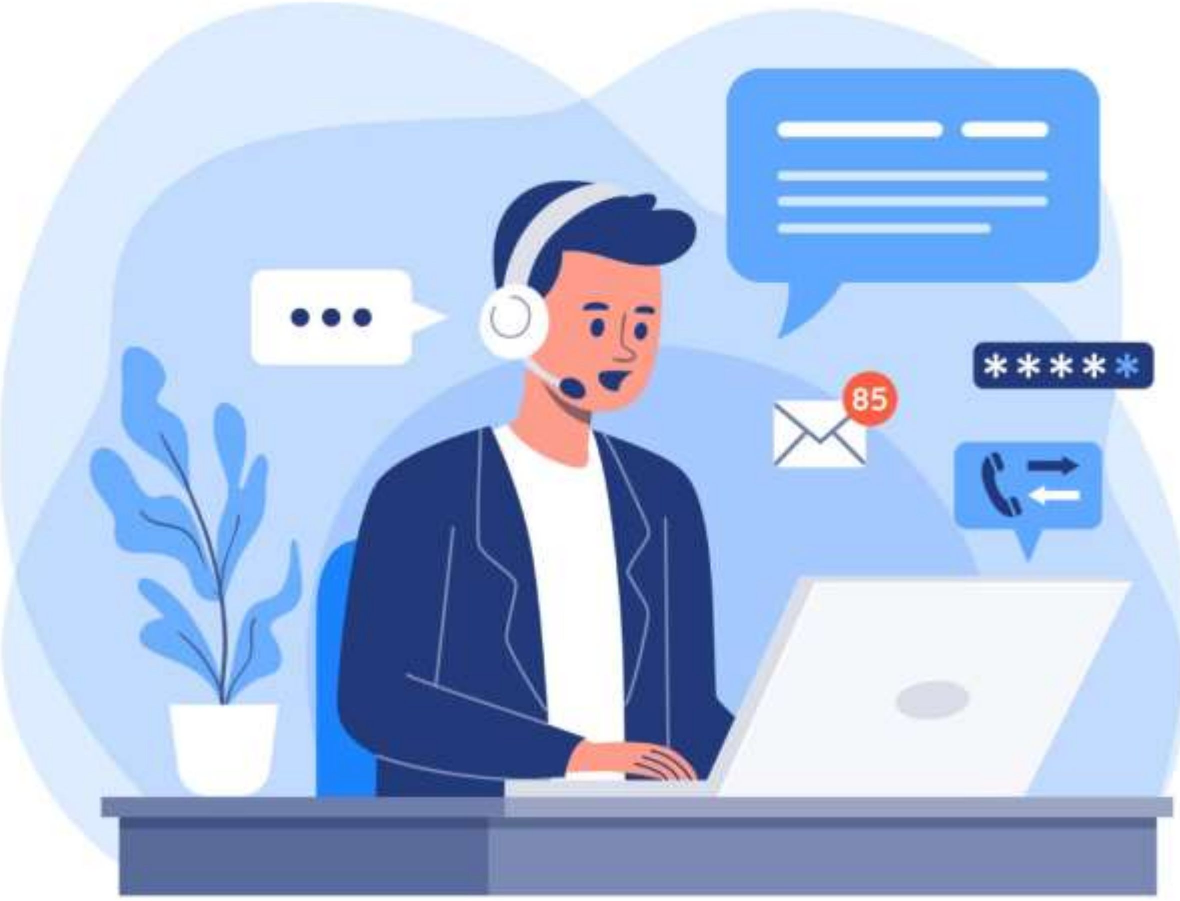

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+91 9540653900