Edexcel (A) Economics A-level

Theme 2: The UK Economy, Performance and Policies

2.5 Economic Growth

2.5.1 Causes of growth

Notes

Economic growth is defined as the expansion of the productive potential of the economy. It can be depicted by an outward shift in the PPF or an outward shift in a country's LRAS curve.

Short term growth is calculated annually by the percentage change in real national output.

Long term growth is a **trend**, which is a potential.

Factors which cause economic growth

- Increase in AD, either from domestic demand or from trade.
- Improving the labour force, with a better quality and quantity to increase productivity. The larger the size of the labour force, the greater the productive potential of the economy.
- Improved technology, which is more productive
- More investment, to fuel economic growth
- **Capital deepening** which is an increase in the size of physical capital stock.

Actual growth

This is the percentage increase in a country's real GDP and it is usually measured annually. It is caused by increases in AD.

Potential growth

This is the long run expansion of the productive potential of an economy. It is caused by increases in AS. The potential output of an economy is what the economy could produce if resources were fully employed.

The importance of international trade for export led economic growth

Export led growth occurs when countries open up their economies to the international market. One of the most famous examples of this is China, which has had export led growth for many years.

International trade is important for this. Countries can specialise where they have a **comparative advantage,** which increases world output and lowers average costs.

A country has comparative advantage when it can produce goods and services at a lower opportunity cost than another.

Export led growth means the economy is **unbalanced,** since there is a surplus on the current account on the balance of payments. Whilst this means there are net injections into the economy, it is not necessarily sustainable.

Moreover, it means the country relies on the economic state of other countries, since these are the consumers of their goods and services. If there is a recession in a major export market, exports will fall and so will economic growth.