Economic growth and public policy

Economics, Macroeconomics

Economic growth and public policy To increase productivity and living standards, governments can can: 1. Encourage saving and Investment: Goal: invest more current resources in the production of capital to increase physical capital (K). Trade-off: The opportunity cost of investment is that someone must forgo current : consumption in order to save and invest sumption Note that: because of diminishing returns, an increase in the saving rate leads to higher growth of productivity and income only for a while. In the long run, higher saving rate leads to a , higher level of productivity and income but not to a higher growth of productivity and ductivity income. Policies: - Saving incentives: lowering taxation on savings will increase saving The quantity of : saving. loanable funds (supply) will increase and the equilibrium interest rate will fall (see supply/demand for loanable funds). Result : higher saving and investment pply/demand - Investment incentives: lowering taxation for firms that build a new factory or buy new equipment for example will increase investment (demand for loanable funds) and the equilibrium interest rate will rise. Result: higher saving and investment. Result: Debate: Some economists argue that such policies to encourage investment policies would have no effect in an economy where there is already unused (idle) capacity due to uncertainty and lack of business and consumption. In such situation, more efficient policies would be to encourage consumption and lower uncertainty (uncertainty (Keynesian economists). 2. Encourage investment from abroad Goal: increase physical capital (K) without being limited by savings of domestic residents. Policies: increase incentives through lower taxation, low uncertainty, low levels of corruption corruption, securing property rights,

maintaining political stability etc stability, 3. Encourage education and training Goal: increase productivity by increasing human capital (H) Trade-off: when students are in class, they are not producing goods and services, education and training has an opportunity cost in the short run, but positive externalities+higher productivity in the long run Policies: to a certain extent, provision of publicly-funded education, scholarships etc. , In developing countries, pay families to encourage them to send their children to school (n encourage (G. Becker) 4. Promote Research and Development Goal: Increase technological knowledge (A) Trade-off: Money used for R&D is not used to produce goods and services (short run) y Policies: Encourage firm to invest in R&D through tax incentives and resea firms research grants, secure intellectual property rights and patent system (encourages research by granting an inventor the ntellectual encourages exclusive right to produce the product for a specified number of years) 5. Promote free trade? Goal: Increasing productivity through specialization. Each country would specialize in what it does best. Policies: Reduction/Elimination of taxes on imports, tariffs, subsidies, quotas to achieve free trade. economists argue that free trade has not necessarily been a good Debate: Some eco policy for every country. Specialization based on what a country does best has resulted in some countries specializing in high-tech, industry and other products with high economies of ts scale; while other countries that specialized in agriculture face diminishing returns => ; ture enlarge gap between developed and developing countries. ap growth? 6. Encourage population growth Goal: increase Labour supply (L) Policies: encourage births or immigration or influence women participation rate in labo labour force

Debate: Some economists (Malthusians) think that an increasing pop population would lead to poverty. Other economists argue t such idea was proved wrong in history since new that ideas and technology have helped increase efficiency and production without being limited by natural resources: increase in population lead to technological progress. : BUT, high population growth reduces GDP per worker, and creates a burden on the education system (high growth= large number of schoo igh school-age children) THUS, how to influence population growth depends on the situation of the country Some of the suggested policies involve increasing government expenditure. Note that: When the government sp spends more than it receives in tax revenues, there is a budget deficit. Public saving falls (T-G), which lowers national saving. The supply of loanable funds will shift G), to the left and the equilibrium interest rate will rise. When the int rest rate rises, the quantity of funds interest demanded for investment purposes falls => Crowding-out effect