Identify and analyse the factors which affect economic growth

Economics

There are many factors which affect economic growth. It is important to first understand what this really means - economic growth is the increase in the productive potential of an economy in real terms and that can be represented by an outward shift in the production possibility curve.

The benefits of this growth will be a higher standard of living because the output will increase so more goods and services can be bought.

The main affecters to economic growth are; A rise in the productivity of existing factors through better organization, education, health and productivity of labour. By doing this the output will be increased because workers and businesses can achieve their full potential. If one firm invests in training in order to raise labour productivity, other firms will also benefit from the improved stock of human capital. These better trained labourers can be hired by other firms. If one firm invests in research and development the benefits can be use by other firms. For example a firm makes better and cheaper components when another firm buys the product they will benefit from the original firms investment into the improvement of the product.

An increase in the quantity of resources such as capital, labour, land and raw materials all affect economic growth.

Capital is important because a nation output depends on its stock, and an increase in this stock will clearly increase output. Investment is very important here because this will lead to a better stock of capital. An example of this could be to invest in better and more efficient robot in a car manufacturer. The reason why output grows is not from building extra machines but instead, finding better machines that produce a higher rate of return. Another example will be the microchip and computers; they can replace human workers and machines. Also improved methods of transport have reduced costs of moving goods and materials. Improved communications such as email and satellites have reduced the cost of transmitting information.

The rate of growth here will depend on the fraction of national income devoted to new investment; the higher the rate of investment, the higher the potential output will be.

A labour increase of the working population will vastly improved potential output. A larger proportion of the working population will be seeking employment which will probably increase the " participation rate." For instance is more women and children want to join the labour market, the working population will rise.

Land can only add tiny amounts to the national output because it is a virtual fixed quantity so land can only be opened up marginally. If a raw material is found a country may " be lucky" and find vast resources of coal, oil and minerals. For instance North Sea gas, which provides huge one off benefits providing short term growth for countries such as Britain. Output will result in being at a higher level until the raw material begins to run out and the output will then fall.

The economic growth of a country can be altered by the government. They may focus on the demand side of the economy by attempting to increase the demand to ensure investment and potential output is turned to actual output. On the other hand they could concentrate on the supply side to increase potential output by encourage research and development, innovation and development.

There are 3 methods which are used to calculate Gross Domestic Product (GDP). These three methods can be shown in a circular flow of income diagram;

The first method in measuring GDP is to add up the value of goods and services produced in the country - the product method. A measurer will focus on firms and add up all their production.

The second method is the income method. The production of goods and services produces wages, salaries, profit, rent and interest. The method is realised when all of these are added.

Finally the expenditure method, this measures the sales value. It focuses on the expenditure necessary to purchase the nation's production. In this simple circular flow of income, with no injections or withdrawals, whatever is produced is sold. The value of what is sold must therefore be the value of what is produced.