SECTION 7.3 PUBLIC GROWTH AND ECONOMIC POLICY

- Economic growth means more than an increase in the real income (output) of the population. Changes in output are accompanied by a number of other important changes. A nation can pursue a number of policies that affect economic growth.
- One of the most important determinants of economic growth is the saving rate. In order to consume more in the future, we must save more now. Generally speaking, higher levels of saving will lead to higher levels of investment and capital formation and, therefore, to greater economic growth.
- Sustained rapid economic growth is associated with high rates of saving and investment around the world. However, investment alone does not guarantee economic growth, which hinges importantly on the quality and the type of investment as well as on investment in human capital and improvements in technology.

Exhibit 1: *Saving Rates and GDP Growth during High-Growth Periods in Selected Economies*

- Some scholars believe that the importance of **research and development** (R & D)—which can include new products, management improvements, production innovations, or simply learning by doing—is understated. It is clear that investments in R & D and rewarding innovators with patents has paid big dividends in the past 50 to 60 years. In addition, there is an important link between research and development and capital investment. When capital depreciates over time, it is replaced with new equipment that embodies the latest technology. Consequently, R & D may work hand in hand with investment to improve growth and productivity.

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- Economic growth rates tend to be higher in countries where the government enforces property rights. In most developed countries, property rights are effectively protected by the government, but in developing countries, this is not normally the case. And if the government is not enforcing property rights, the private sector must respond in costly ways that stifle economic growth. (Examples include private security, bribes, corruption, confiscation, and the risk of takeovers from a new government.)
- Free trade can lead to greater output because of the principle of comparative advantage. Essentially, it suggests that if two nations or individuals with different resource endowments and production capabilities specialize in producing a smaller number of goods and services they are relatively better at and engage in trade, both parties will benefit. Total output and consumption will rise.
- Education, or investment in human capital, is just as important as improvements in physical capital. Accepting a reduction in current income to acquire education and training can increase future earning ability, which can raise the standard of living.
- With economic growth, illiteracy rates fall and formal education grows. The correlation between per capita output and the proportion of the population that is unable to read or write is striking. Improvements in literacy stimulate economic growth by reducing barriers to the flow of information and raise labour productivity.
- One problem of providing enough education in poorer countries is that since children in developing countries are an important part of the labour force at a young age, there

is a higher opportunity cost of education in terms of forgone contribution to family income.

- Education may also be a consequence of economic growth, becoming a consumption good, as well as a cause of economic growth, creating human capital.

Exhibit 2: *Literacy and Economic Development*