We often hear the term “economic growth” when discussing economics. Personally, I have been hearing this term for many years, especially on the news, without understanding what it means. As such, I hope that you will understand what this means in a deeper sense. That said, let us discuss the different types of economic growths.

Actual Growth

Actual growth, or actual economic growth, refers to the increase in the actual national output of a country. In most cases, the real GDP is used to calculate the actual growth of the country. We can calculate this using the formula:

Actual GDP Growth Rate = $[(GDP_t - GDP_{t-1}) \div GDP_{t-1}] \times 100\%$

If the actual growth of a country is negative for two consecutive quarters, we consider it to be in a technical recession.

Factors of Actual Growth

There are two main factors that determine the magnitude of the actual growth of the economy – the increase in the aggregate demand (AD), and the decrease in the unit cost of production (UCOP).

Assuming that there is spare capacity in the economy, an increase in the AD will result in positive actual growth, and vice versa. When the AD rises, there will be an unplanned fall in inventories. As such, producers will increase the production of goods or services, and employ more factors of productions (FOPs). This results in a multiplied increase in the actual growth of the economy.

When there is a decrease in the UCOP of a good or service, the aggregate supply (AS) will increase. Assuming that the AD remains unchanged, the increase in AS will cause the general price level of the good or service to decrease. This causes an increase along the AD curve, which eventually restores the equilibrium of the economy at a higher national output.

Potential Growth

Potential growth, or potential economic growth, refers to the increase in the capacity of the economy to produce. In other words, this refers to the expansion of the country’s potential national output.

Factors of Potential Growth (Quantity of FOPs)

When we discuss the factors affecting the number of FOPs, it usually leads us to these four aspects – capital, entrepreneur, land, and labour.

Capital

When the capital of a country increases, it can produce more goods and services. This increases the production capacity of the country. As investments will increase and depreciation will decrease the capital stock of the country, a positive net investment will cause the capital stock to rise. The investment consists of domestic and foreign investments, by domestic firms and foreign firms respectively.

Entrepreneur

Entrepreneurs gather FOPs to produce goods and services. They also carry the risk of losses during production and invest in research and development (R&D). With more entrepreneurs, the potential growth of the country will increase, as there will be more investments in R&D.

Land

Land refers to the natural resources found within the country – it can be discovered and depleted. There is less potential to increase natural resources, as they are limited. As such, it can only increase the potential growth of the country in a few ways, such as optimising the use of land in buildings.

Labour

There are two ways to increase the labour force to increase the potential growth of the country – increase the average working hours, and expand the labour force. This can be done by increasing the participation rate of the labour force and increasing the foreign worker inflow.

Factors of Potential Growth (Quality of FOPs)

The quality of FOPs refers to the changes in the productivity of FOPs, which affects the rate of potential growth. We can measure the quality of factors of production by measuring the labour productivity or the total factor productivity. Labour productivity refers to the amount of output obtained for every unit of labour involved in the production of the good or service, whereas the total factor productivity refers to the amount of output obtained from a given quantity of all inputs used in the production of the good or service.

There are three factors affecting the quality of FOPs:

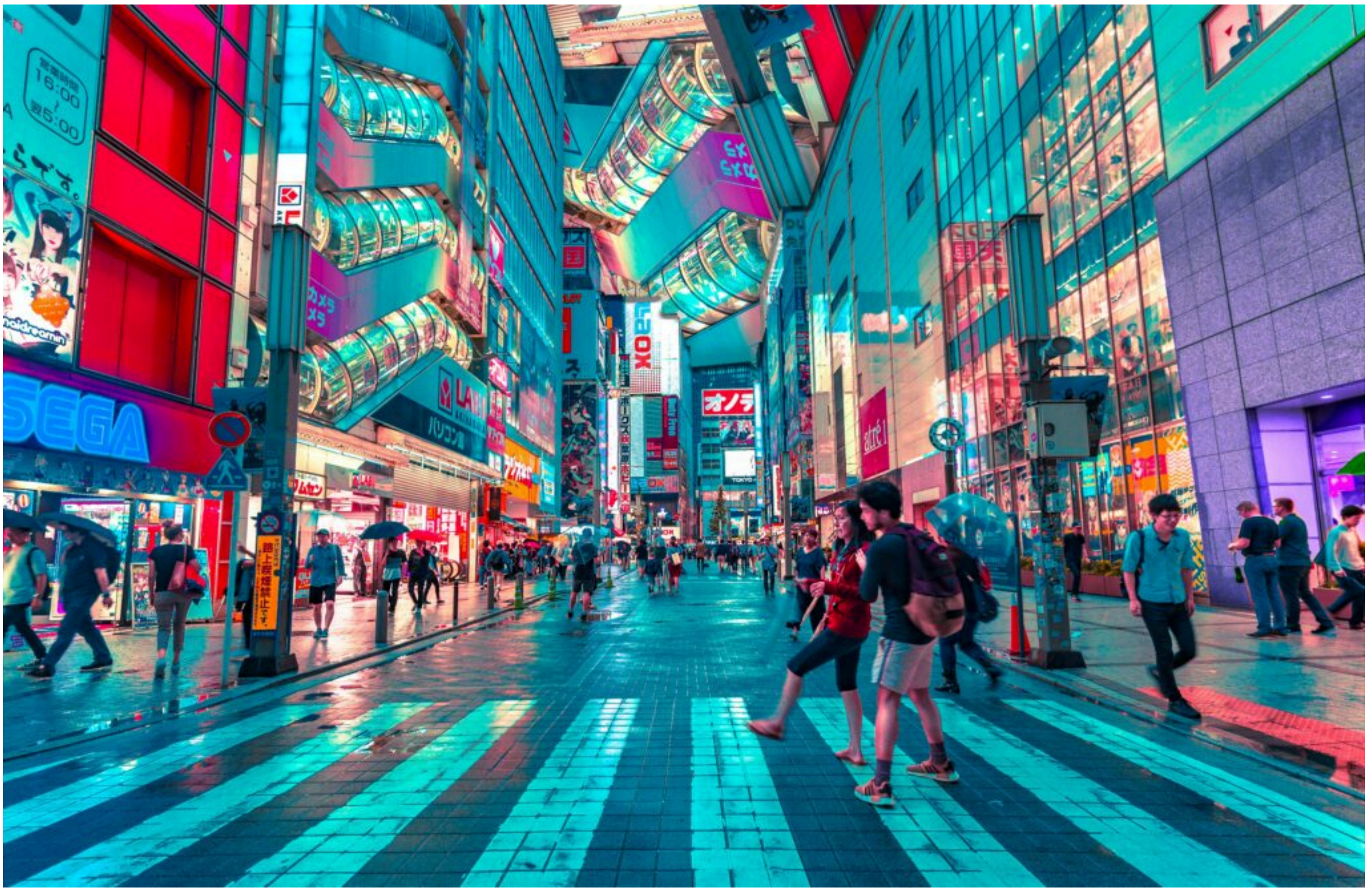
- Human capital – knowledge and skills gained by workers from education, experience and training
- Physical capital
- Technology – enable FOPs to produce more goods and services within the same given time

Sustained Growth

Sustained growth, or sustained economic growth, occurs when the real national output of the economy increases over an extended period without the inflation rates accelerating. As such, there is no increase in the general price level.

As the potential national output does not increase, the increase in equilibrium real national output will end, since there is no more spare capacity in the economy for actual growth. With that, both the potential output and the actual output must increase to ensure sustained growth of the economy.

Governments usually aim for their country's real GDP to increase in the long run. However, they may encounter unstable short-term growth rates.



Sustainable Growth

Sustainable growth, or sustainable economic growth, is the sustained growth rate that does not result in other significant socio-economic problems. As high growth rates result in our planet's resources being depleted and exhausted faster, governments should prioritise slower sustainable economic growth.

Making economic growth sustainable

Natural resources are depleted faster if economic growth is attained when natural resources are discovered. As such, this is not sustainable. To counter this, we can make economic growth sustainable by making the resources we use more efficient.

On top of that, governments can eliminate subsidies for fossil fuels and, at the same time, encourage the allocation of resources to environmental-friendly alternatives. The government can achieve this by subsidising the solar and wind power industries. They can also invest in R&D in these sectors to minimise the negative impacts on the environment. The governments can also implement policies, such as taxes and laws, to minimise the use of natural resources and slow down their depletion.

Inclusive Growth

Inclusive growth is the sustained growth that is broad-based across different economic sectors. This presents productive employment opportunities to as many residents of a country as possible.

Making economic growth inclusive

Economic growth can be made more inclusive by:

- Redistributing income – ensure more income equality
- Increasing the equality of opportunities – ensuring access to high quality education, upgrading of skills, and providing funds for entrepreneurship

Benefits of Economic Growth

The first thing that comes to mind would be that households enjoy higher standards of living in the long run. With an increase in actual growth, residents of a country enjoy a higher real income per capita. This essentially means that there is an increase in the material standard of living of residents. At the same time, governments can earn more tax revenue, which can help to improve both the material and non-material standards of living of residents.

With economic growth, governments can manage other macroeconomic issues. Actual growth can help to minimise demand-deficient unemployment since the increase in AD results in an increase in output. Potential growth prevents demand-pull inflation that may result in inflation. On top of that, governments can also work on sustainable and inclusive growth.

Costs of Economic Growth

However, not everything about economic growth is beneficial to the country. Households will suffer a lower current material standard of living since there must be an increase in the potential growth of the economy. They will also suffer a lower non-material standard of living, as workers may have to work longer and harder.

With economic growth, governments have to make trade-offs with other macroeconomic issues. This may cause an increase in the structural unemployment of the country or a deterioration in the balance of trade of the country. There may also be a decline in inclusive growth due to income inequality.