

LECTURE V

14 February 2012

TOPIC 5

Growth Policies (continued)

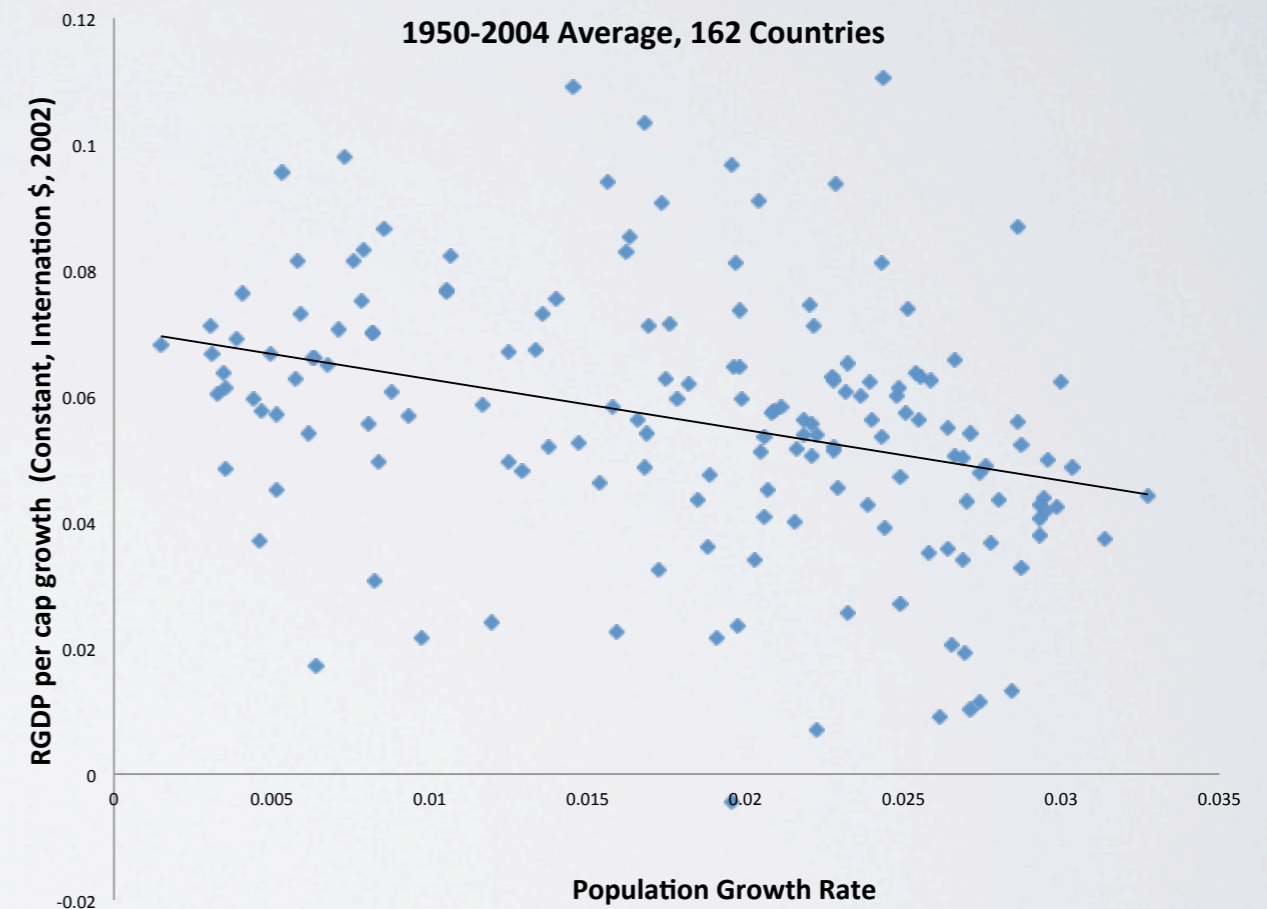
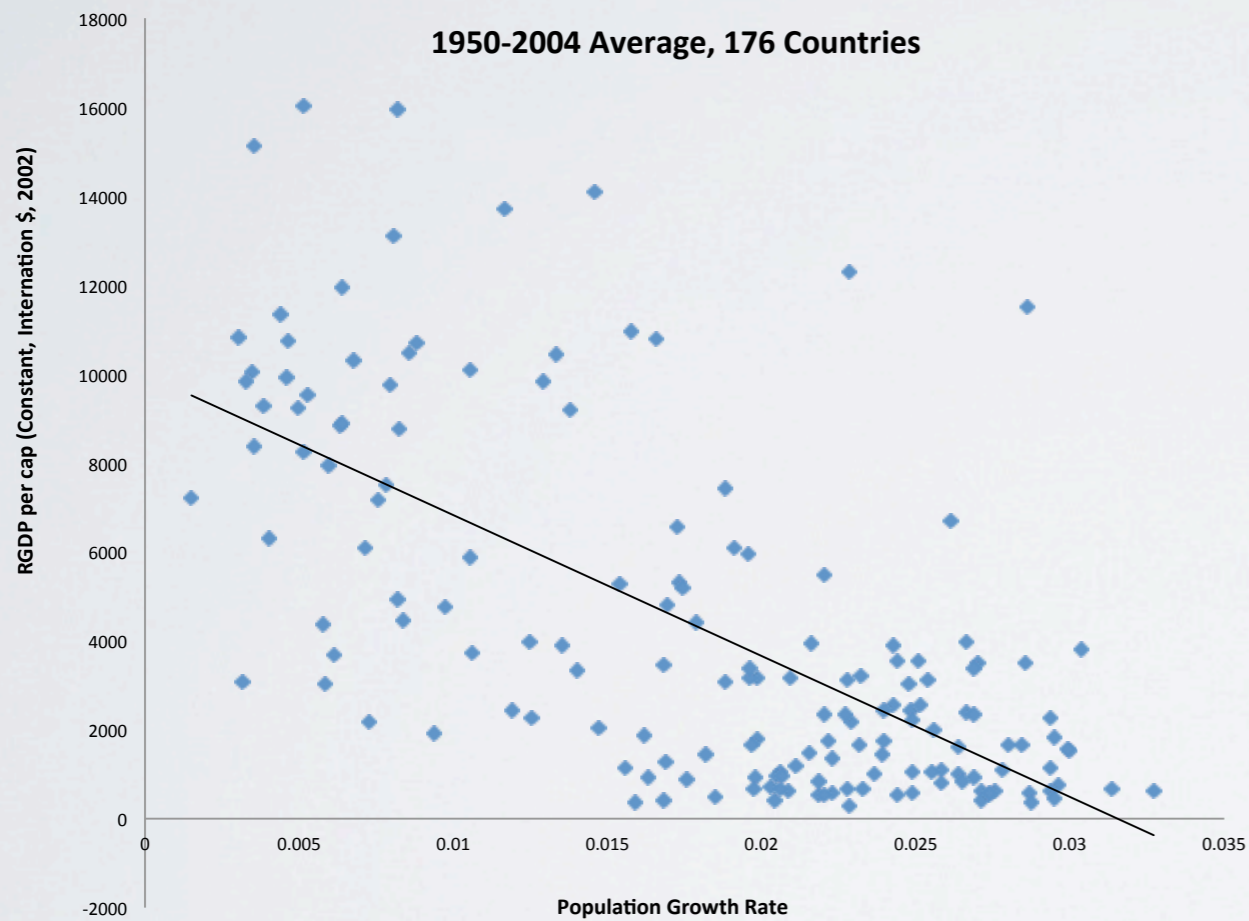
RECALL: HOW DO WE PROMOTE GROWTH?

1. Enhance Human Capital
2. Saving and Investment
3. Property Rights and Stability
4. Free Trade
5. Patents and Copyrights
6. Population and Growth

OTHER FACTORS

- Property rights: How might a weak political regime or poor property rights impact growth?
- Free trade: think of trade from micro; comparative advantage permits productivity gains
- Patents and copyrights: recall patents and monopolies from Micro? What negatives are there?
- Population and Growth: does high population cause low RGDP growth or high RGDP cause low growth

CORRELATION OR CAUSATION



HYP 1: HIGH POPULATION GROWTH LEADS TO LOW RGDP GROWTH

1. Simple numerical issue

- Suppose RGDP growth is 2% and population growth is 1%, start with \$1000, and 1000 people. What is RGDP per capita growth?
- With 2% population growth?
- With 3% population growth?
- There is a pacing issue

2. Nuanced issues - large families can save less, which hinders growth; there are more agricultural demands; what else?

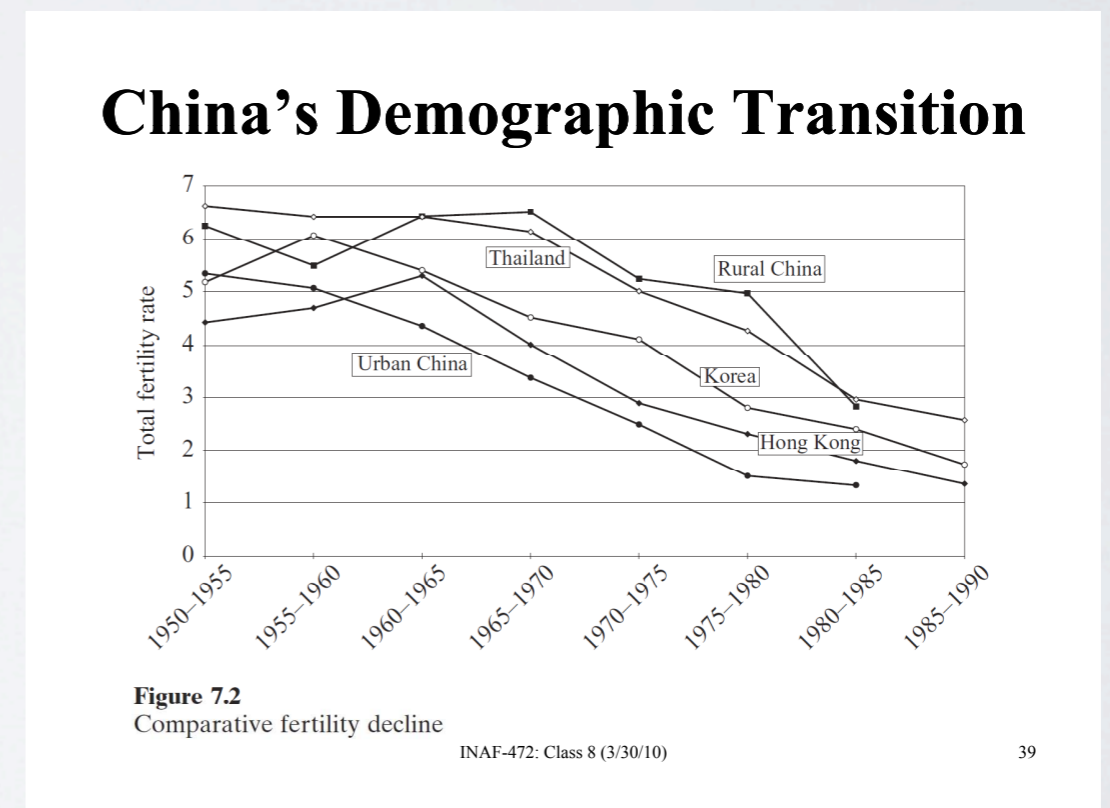
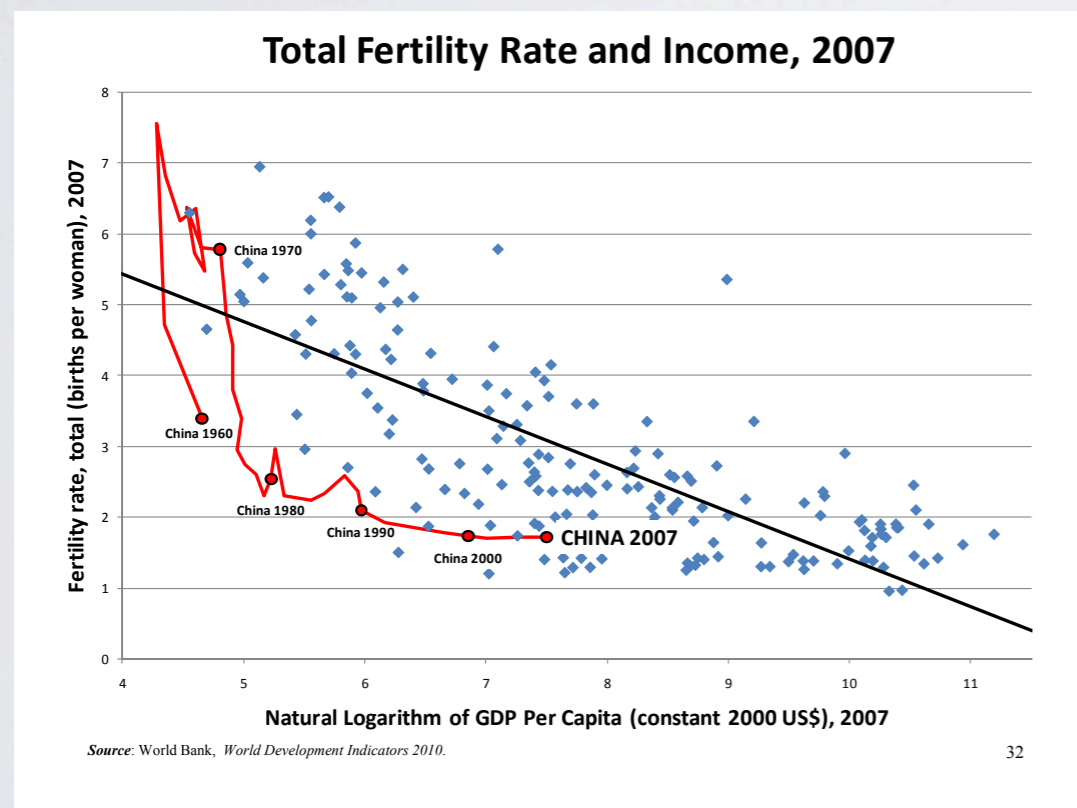
3. Are there benefits, though?

HYP 2: HIGH RGDP GROWTH TO LOW POPULATION GROWTH

- **Demographic Transition Theory:** Rising incomes lead to slower population growth. Children become “more expensive” with national wealth
- The reverse may also be true (again, correlation v. causation)
 - Demographic dividend: rise in economic growth because of larger working share of population relative to non-workers (children and elderly)
 - Considered an extremely valuable period in development (Bloom and Williamson, 1998)

DEMOGRAPHIC TRANSITION

- Part of the motivation for the 1980 one-child policy in China



IS GROWTH SUSTAINABLE AND DESIRABLE?

- Unsustainable:
 - Perhaps technological innovations will eventually cease
 - Perhaps growth theory is only a temporary phenomenon
- Sustainable
 - Resource prices are not increasing
 - Growth's only true limit is the limit of human creativity (Steve Jobs created many new markets)

IS GROWTH SUSTAINABLE AND DESIRABLE?

- Undesirable:

- Growth increases pollution, environmental degradation
- More money can carry costs in loss of leisure, desire to work
- High growth can cause stress

- Desirable:

- Wealth has increased environmental sensibilities
- Growth has improved working conditions
- Growth is the key to poverty reduction

PROS AND CONS OF GOVERNMENT POLICY

ROLES OF GOVERNMENT

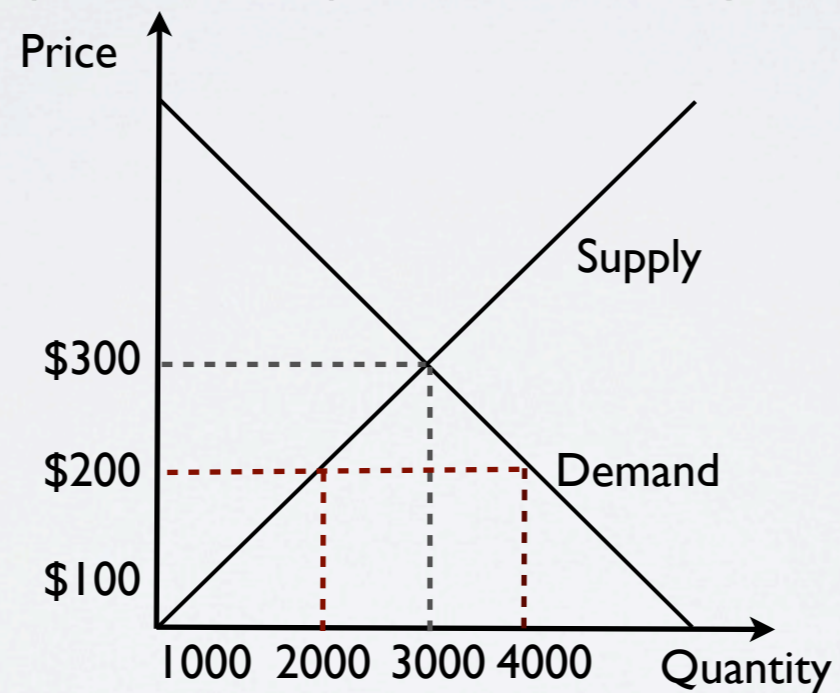
- Regulator
 - Provide legal structure
 - Maintain competition
 - Promote stability (economic problems, for example)
- Equalizer
 - Provide public goods and services
 - Redistributing Income
 - Reallocating Resources

ROLES OF GOVERNMENT

- Which interferences can come at a cost to efficiency (think Pareto efficiency) of the market?
- Why would we want government to intervene in the marketplace?

PRICE CEILINGS

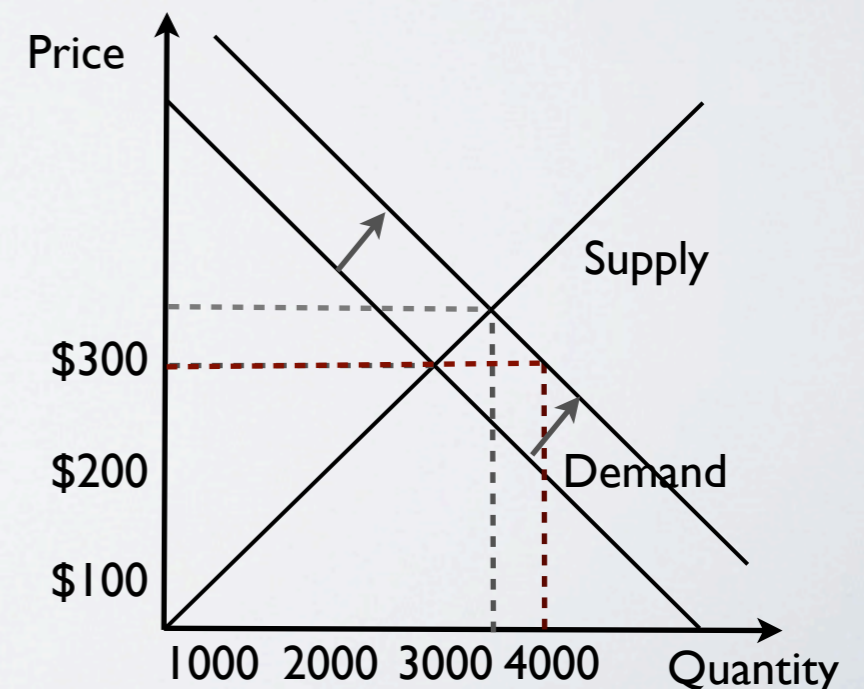
- Suppose the government wants to decrease the cost of smartphones and imposes a price ceiling of \$200



- Price ceilings can cause **supply shortages** (here by 2000 units), which reduces well-being if the market was initially efficient (what theorem tells us this?)

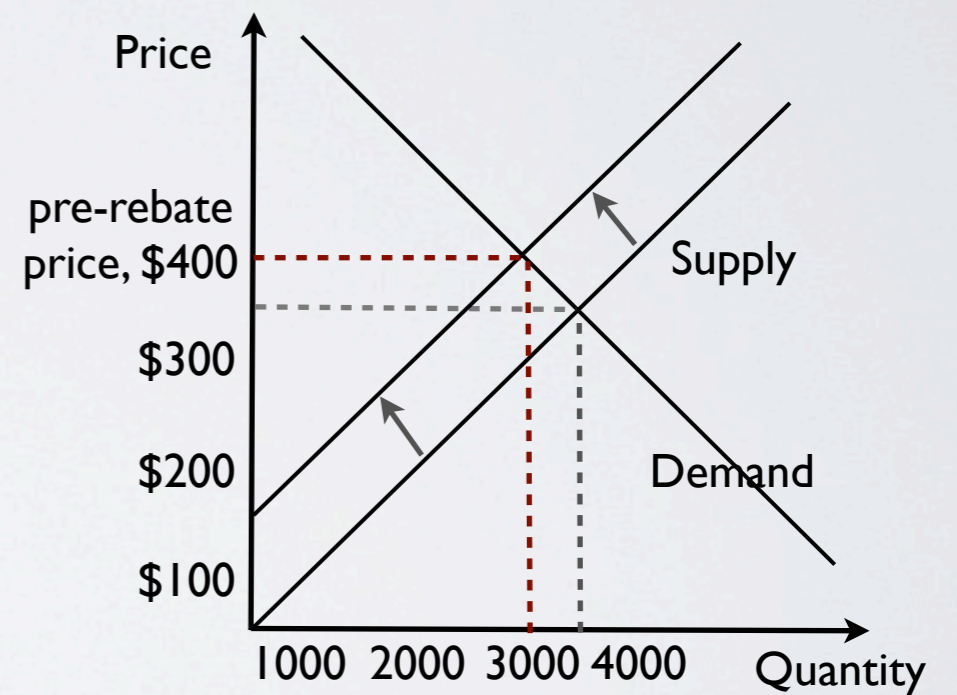
PRICE REBATES

- Instead, suppose the government wants to increase supply through a rebate, why?
 - Supply increases can reduce price
 - Lower firm taxes might show favoritism and reduce competition
 - A **rebate** promises consumers a certain government refund back for every purchase
 - Consumers act like they have the lower price
- Offer a \$100 rebate
 - Demand shifts so at \$300 (by how much?)
 - Demand is 4000 units now
 - Note price could increase or decrease after rebate



TAXES

- Rebate cost money (in that case \$100 per unit) and must be funded through loans or taxes
- Suppose the government levies taxes on manufacturers
 - \$100 for every unit
 - Try this on a marked graph to see this returns the economy to its original equilibrium

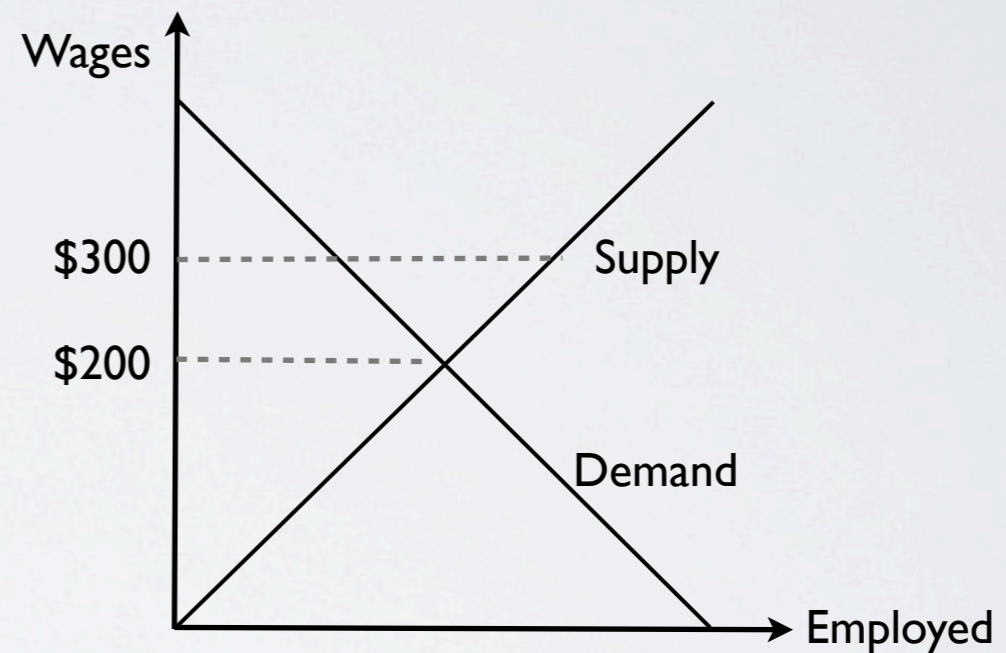


INCREASE SUPPLY

- Shifting the supply curve out is a clean way to reduce price and increase quantity
- How?
 - Imports by opening to trade
 - Promoting new production technology
 - What else?

MINIMUM WAGE

- Maybe the problem with phones is that wages are too low, so the government sets a minimum wage of \$300 a year



- Problems if the floor (recall the minimum wage is a price floor) is binding?
 - Higher wages increase unemployment (i.e. people without income at all)
 - Supply cost increases increase cost of smartphones

REVIEW

- Economic growth is generally viewed as positive and inevitable but there are questions of sustainability and desirability
- Assuming we want growth, policymakers have a number of tools that observationally support long-term economic growth