Economic Growth as a Policy Objective

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In the formulation of economic policy, economists focus *inter alia* on proximate objectives that encompass the aims of efficiency, inter-generational and intra-generational equity. It can plausibly be argued that, in practice, economic growth is a necessary condition for the attainment of such aims. This paper discusses the nature of economic growth, and the consequences to which it gives rise.

The discussion is divided into three sections. The first of these outlines the nature of growth and the growth process. The second discusses the measurement of growth, analyzing the relative efficacy of GDP as a proximate measure. Finally, section three examines its desirability, delimiting the complementary effects and trade-offs which must be borne in mind.

The nature of growth

Most lay commentators would subscribe to the objective of economic growth, a fact borne adequate witness to by the impassioned commitments to the goal of growth which appear regularly in election manifestos. Yet, economic growth, as with most objectives, involves a trade-off. To believe that future higher consumption can be attained with unchanged current consumption is to deny the workings of the real economic system. "Nothing will come from nothing," as Lear was wont to argue. This trade-off is captured in society's social time preference rate - the rate at which agents collectively discount future consumption.

Implicit in the concept of growth is an increase in the welfare and resources available to an economy which facilitate the achievement of other objectives. For example, an enhancement of the stance and "goodwill" of an economy in the international climate can be construed as growth. However, for many purposes, such a qualitative interpretation is unsuitable, and hence a more tractable definition must be adopted. In the current context, growth will simply be taken to mean an increase in the output of goods and services in the economy.

The two most important ingredients in the growth process are investment and technological advance. Yet these inputs will not necessarily provide an optimal rate of economic growth. Individuals make intertemporal choices based on their private time preference rate. The level of savings which these choices generate may meet the optimal investment requirement of the economy, but it may equally generate a sub-optimal level. This occurs if market imperfections impinge in capital markets. The consequence is that the social returns to growth may exceed the social discount rate, imputing a loss of aggregate welfare.

Yet even if the requisite level of investment is realized, it may not be channelled in the most effective way. The importance of technical progress to society and social welfare is often underestimated. It is arguable that the benefits to society of enhanced technology surpass those to investors and innovators. It is for this reason that governments intervene in the investment market, offering incentives and grants, and setting the rules of the game by issuing patents.

Measurement

If our concern is with the measurement of social welfare, the only perfectly legitimate procedure is to consider the consequences of each and every economic reorganization entailed by the growth process, and to determine which of these are beneficial and which are detrimental. However this is impractical, since we cannot foresee the consequences, tangible or otherwise, of the economic and social reorganizations resulting from a succession of interdependent technological innovations. Our objective then must be to approximate welfare adjustments.

One quantitative measure which furnishes such an approximation is the change in GDP, or more usefully, GDP per capita. The assertion that output per capita and social welfare are associated rests on the assumption that the welfare of individuals depends on the goods and services that they consume. At a theoretical level, it seems appropriate to exclude replacement investment and include net transfer income from abroad. However, the adoption of GNP and NNP as alternative measures arguably clouds the issue, since they tend to move in unison with GDP.

It is worth re-emphasizing that care must be taken when using this measure, since it is far from perfect. It fails to take account of externalities such as pollution which are viewed as a by-product of "growth-mania". Such costs defy measurement. Indeed, paradoxically, the growth rate may include as output, costs which have arisen from productive processes, such as medical costs. Yet while GDP has its limitations, no preferable quantifiable alternative exists, and so we are compelled to use it, albeit with appropriate caution.

Desirability of growth

The desirability of robust economic growth is much mooted. One of the more conventional justifications is that, at a micro level, individuals strive to acquire an increased possession of material goods. However, much more needs to be said.

As was mentioned above, implicit in the concept of economic growth is an improvement in the general welfare of the population. One manifestation of this is the general feeling of confidence and optimism that is palpable during "boom" periods. Social change can be enacted at such times, stemming from the pool of additional resources available to society as a result of expansion. A growing economy is a dynamic one, with change spawning further adjustment. In contrast, a stagnant economy is one with anaemic social processes. Economic growth can thus be perceived as providing the driving force behind society, a force which dissipates when economic growth ceases.

A small but influential body of opinion argues that the above justifications pale in significance when compared to such issues as the depletion of natural resources and the debilitation of the environment which arise as a consequence of growth. It must be admitted that "careful" economic growth is preferred. Yet natural resources are not ornaments. They are there to be used, not ignored. And when they are exhausted, alternatives will be found. A certain amount of pollution is an unavoidable consequence of economic growth, but this cost must be set against the multiple benefits which accrue. These are issues which should be tackled directly. Limiting economic growth is both short-sighted and inefficient. Indeed, since existing enterprises account for much of pollution, attention should be focussed on them rather than on the industries which will pollute in the future as the economy grows.

It is clear then that economic growth is incompatible with certain other equally plausible objectives. However, the concomitant effects which occur in the arena of government policy deserve particular attention.

Growth does complement certain other policy objectives. Increased labour mobility and higher turnover are essential prerequisites for dynamic economic growth, and this attracts new agents to the labour market. In this way, when the economy expands, employment increases more than proportionately. Growth and equality are also complementary. Since growth implies relatively higher income in the future, intragenerational redistribution is possible (in the future) with changes in relative incomes only. Enhanced equality can thus be achieved over time without an absolute reduction in anyone's standard of living.

Having said this, it is possible to argue that there is a significant trade-off between growth and equality. Savings fuel growth which leads to higher future incomes. On one interpretation, this causes the marginal propensity to save to rise, causing further growth. It thus follows that enhanced equity may lead to a drop in savings and investment, stunting growth. The conclusion then is that, in assessing the relative merits of growth, due consideration must be given to the concomitant effects which arise. There is no simple answer to the question "Is economic growth desirable?"

Conclusion

This paper has discussed the nature, measurement and desirability of economic growth, an objective which occupies much of the attention of policy makers. It is perhaps the most proximate of policy objectives. Its underlying premise, an increase in society's general welfare over time, is veiled by concentration on specific measures. It cannot be accorded absolute priority, nor can it be pursued in isolation. Ultimately, its pursuit as a policy objective represents a value judgement - albeit one to which the majority subscribe.