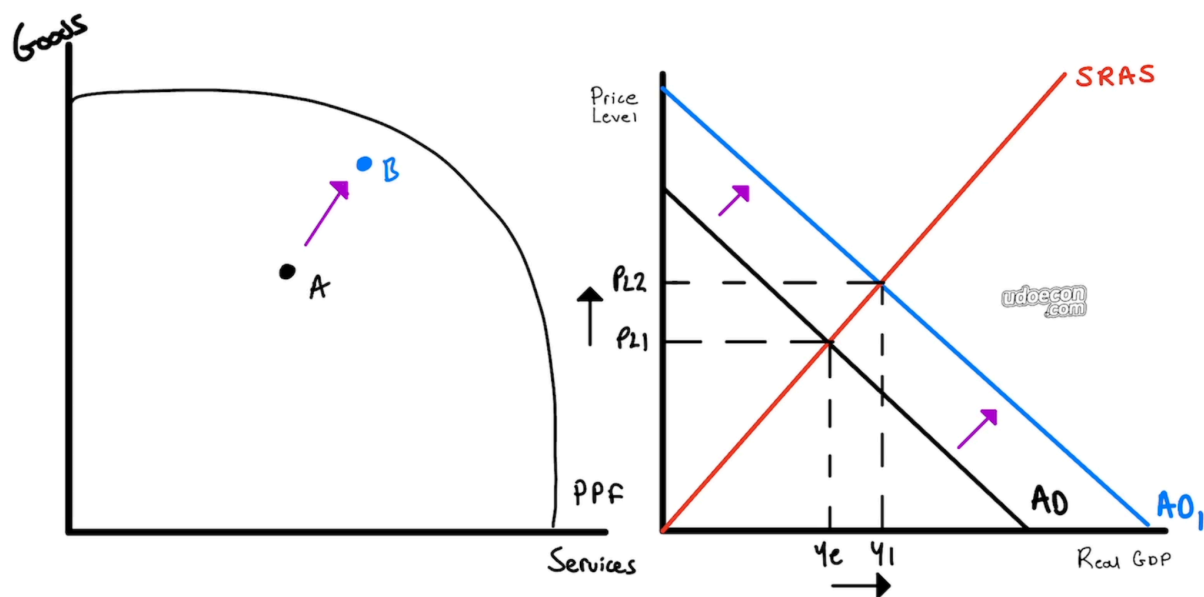


Causes of Economic Growth

Economic growth is an increase in **real GDP**.

Growth can happen in the **short run** (mainly driven by demand) or the **long run** (driven by the economy's capacity to produce).

Short-run economic growth (Actual Growth)



Short-run economic growth occurs when **aggregate demand (AD) increases**, using up the spare capacity in the economy to increase output - this is actual growth .

Short-run growth on an AD/AS diagram

Causes of an increase in aggregate demand

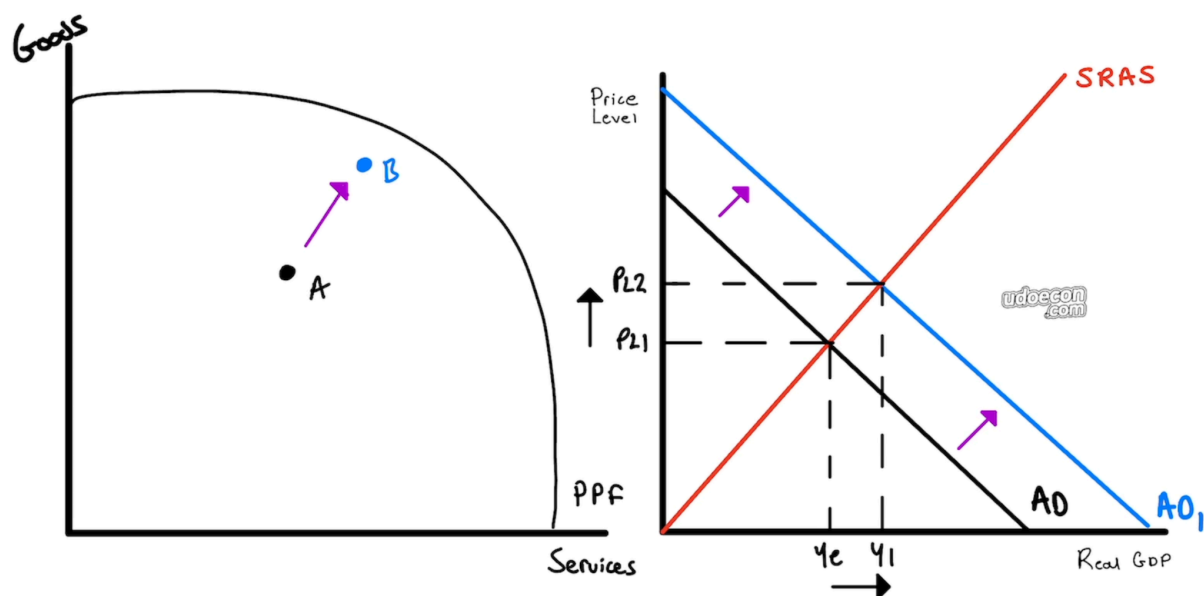
An increase in any component of AD can cause short-run growth:

- C (consumption)
- I (investment)
- G (government spending)
- $(X - M)$ (net exports)

Diagram analysis

On the AD/AS diagram, aggregate demand shifts right from **AD to AD₁**. This leads to an increase in real output from **Y₁ to Y₂**, showing higher real GDP. The price level may also rise from **P₁ to P₂** as stronger demand creates upward pressure on prices.

Short-run growth using the PPF



Short-run growth can also be shown using the **production possibility frontier (PPF)**. Growth occurs when the economy moves from a point **inside the PPF**, where resources are underused, to a point closer to the frontier.

Diagram analysis

Production moves from **point A to point B**, increasing the output of goods and services. The PPF itself does not shift, showing that productive capacity has not changed. This reflects better use of existing resources, such as lower unemployment.

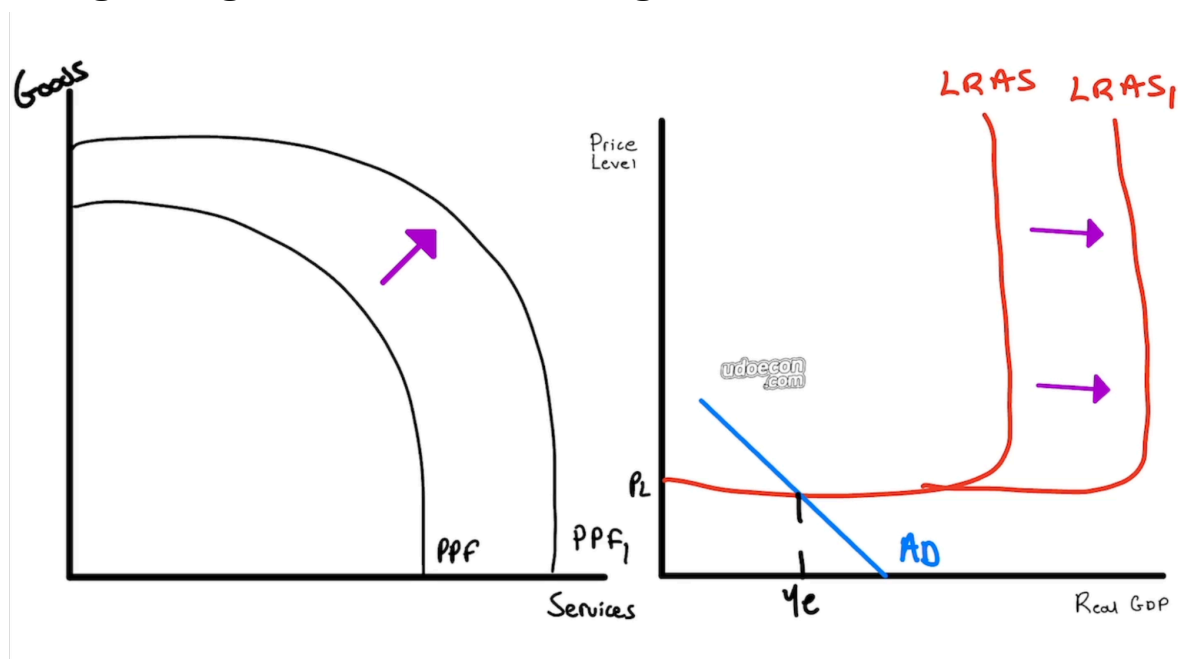
Because real output is higher than before, this movement represents **short-run economic growth**, even though the economy's maximum potential output remains the same.

Long-run (potential) economic growth

Long-run or potential economic growth occurs when an economy's productive capacity increases (an increase in LRAS).

Written by udoecon.com

Long-run growth shown using a PPF



On a PPF diagram, long-run growth is shown by an **outward** shift of the PPF from PPF to PPF1. This shows that the economy can now produce more of both goods and services than before.

As a result, the maximum attainable level of output increases, representing higher potential growth.

Linking the PPF to LRAS

The outward shift of the PPF leads directly to a **rightward shift** of the LRAS curve from LRAS1 to LRAS2. This is because both diagrams are showing the same underlying concept of productive capacity.

The PPF shows the economy's maximum productive potential, while LRAS represents potential output in the economy, known as full-employment output. When the PPF shifts outwards, potential output increases, causing LRAS to shift to the right from LRAS to LRAS1.

Factors which could cause economic growth

Long-run growth is mainly driven by **supply-side improvements** that raise productivity and capacity. Some factors can also support demand in the short run, especially through higher investment and spending.

Capital investment

Investment in **physical capital** (machinery, infrastructure, factories) raises productivity and increases potential output. Example: building new factories; upgrading transport networks

Technological advancements

Improved technology increases efficiency (more output from the same inputs) and can create new products and industries. Example: IT AI improvements raising productivity.

Human capital development

Better education and training increases workers' skills and productivity, raising potential output over time. Example: more funding for apprenticeships

Natural resources

New discoveries or improved exploitation of resources can raise output and export earnings. Example: oil discoveries supporting rapid growth

Government policies

Policies that encourage spending and investment can raise growth, particularly by boosting investment and productivity. Examples: tax incentives; lower interest rates encouraging borrowing and investment

Institutional factors

Strong institutions reduce uncertainty and protect incentives to invest, which supports long-run growth. Examples: secure property rights; effective regulation; political stability attracting investment

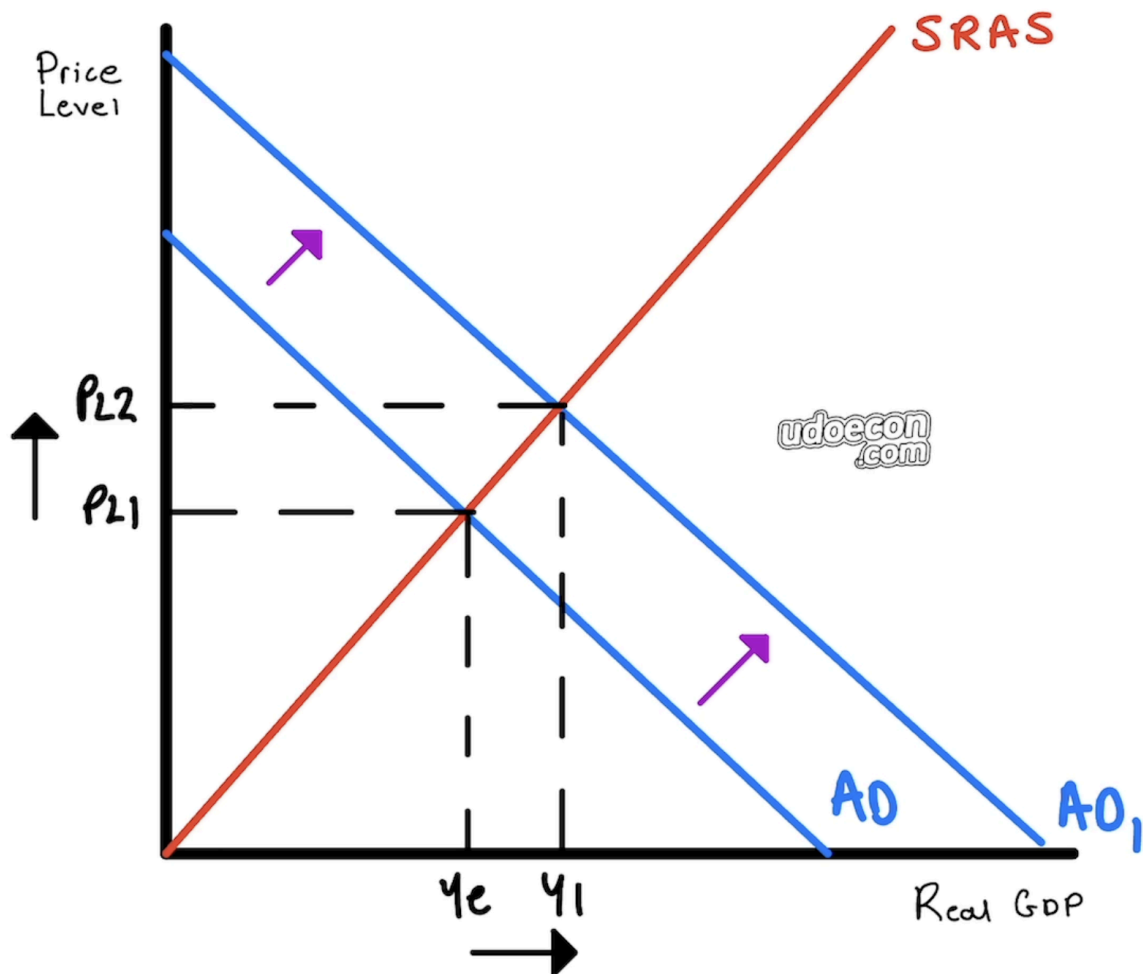
Population growth

A growing population can increase the labour force and expand the consumer base, although the impact depends on productivity and dependency ratios. Example: immigration increasing workforce size

Actual vs potential growth

Actual growth

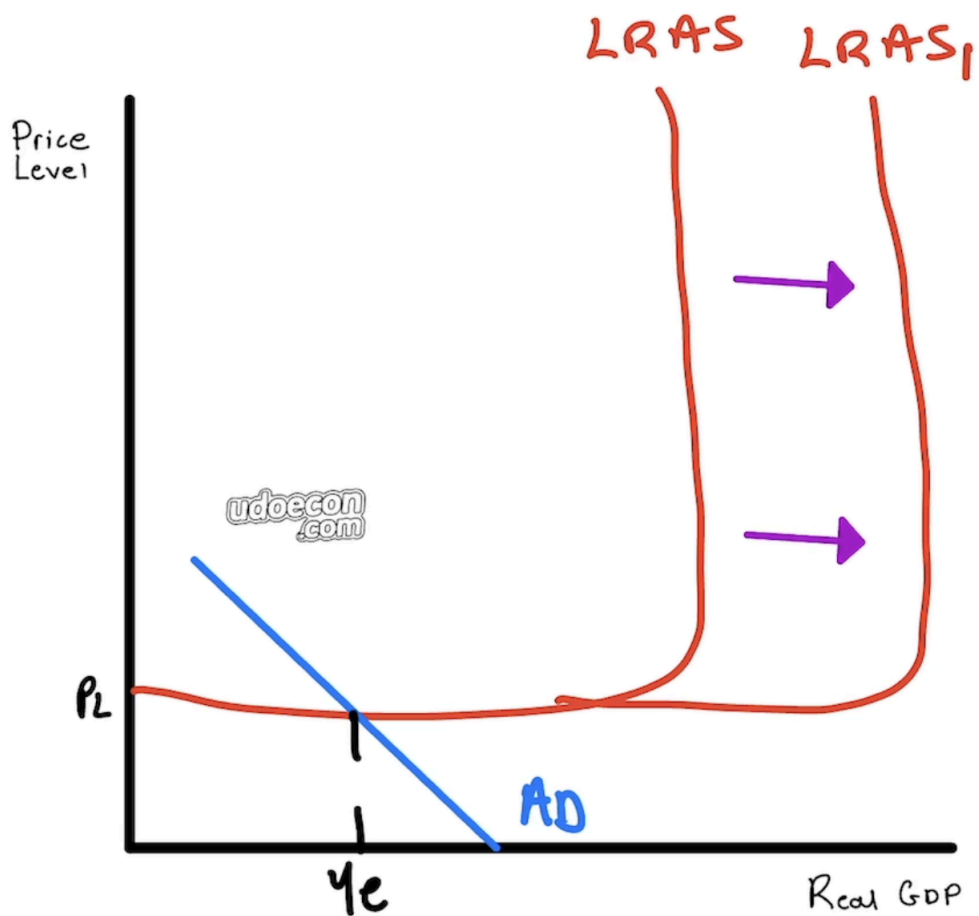
Actual growth is an actual increase in **real GDP** .Real GDP has increased from Y_e to Y_1 here thus is actual economic growth .



Potential growth

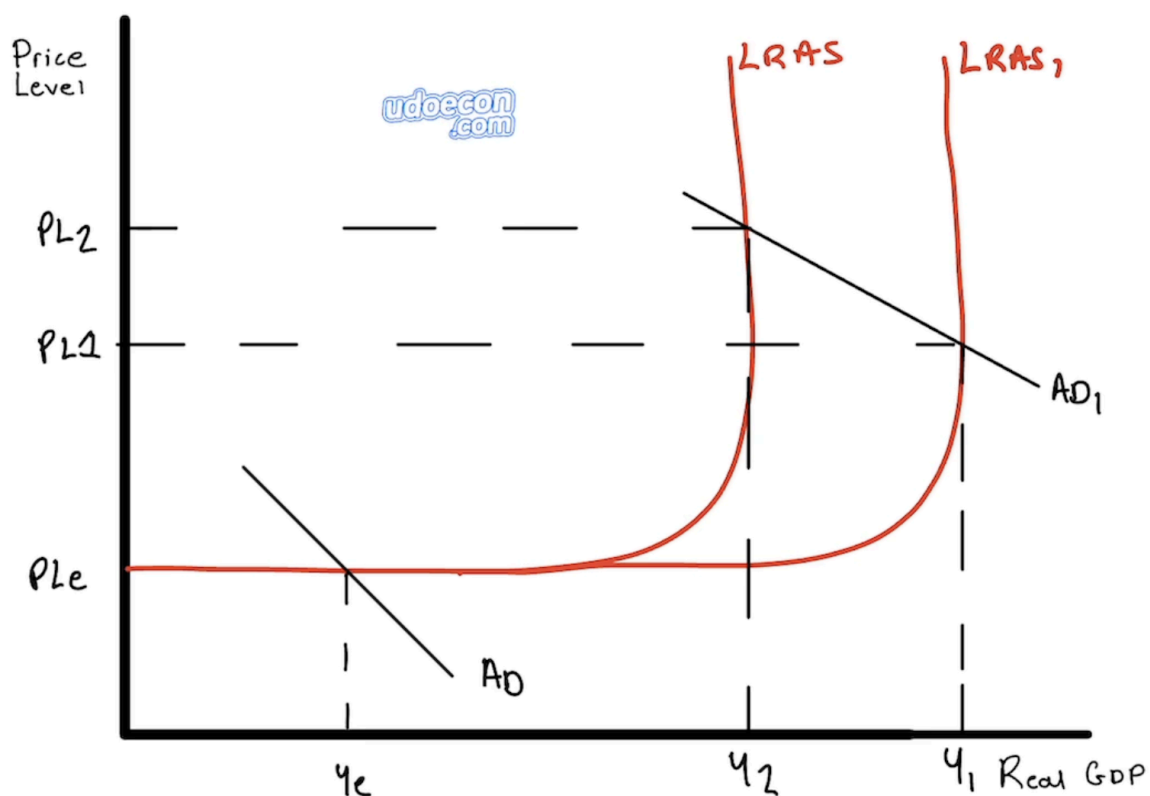
Potential growth is the increase in the economy's **productive potential**, no actual RGDP growth . For example on the diagram despite LRAS shifting out (potential growth) there is

no real growth as real gdp remains at Y_e .



Actual and potential growth

When both **AD increases** (increasing Real GDP) and **LRAS increases** (increasing the productive potential of the economy) .



International trade and export-led economic growth

Export-led growth is growth driven by an increase in **exports (X)**, which raises AD through higher **net exports (X-M)**. This matters most when exports make up a large share of GDP.

How exports can raise growth

- Bigger market size: firms sell to global markets and can exploit economies of scale
- Foreign exchange earnings: exports earn currency to pay for essential imports (e.g. energy, capital goods)
- Technology transfer: global competition encourages adoption of better methods and technology
- Employment and incomes: export industries create jobs, raising household income and consumption

Real-world example

South Korea's export led strategy used global sales to inject capital that triggered a domestic spending multiplier, successfully turning a war torn nation into a top tier global economy in just a few decades.