Chapter 10 long-run Page 2

Classical Long-Run Policy

Chapter 10-1

Chapter Goals

- Define growth, list its benefits and costs, and relate it to living standards
- Discuss the relationship among markets, specialization, and growth
- List five important sources of growth
- Explain how the sources of growth can be turned into growth

Growth and the Economy’s Potential Output

The analysis of growth focuses on forces that shift out the production possibility curve
Growth and the Economy’s Potential Output
- Growth is an increase in potential output
- Potential output is the highest amount of output an economy can produce from existing production processes and resources
- Productivity is output per unit of input
- The long-run growth focus is on how to increase potential output
  - Say’s Law is that supply creates its own demand
- The short-run focus is on how to get the economy operating at its potential

Importance of Growth for Living Standards
- Growth in income improves average living standards
- Because of compounding, long-term growth rates can make huge differences
- The rule of 72 states:
  - The $\text{# of years to double income} = \frac{72}{\text{growth rate}}$
- If China's per capita income of $6,500 grows 8% per year and the U.S. per capita income of $50,000 grows 1% per year:
  - Within 27 years per capita income in China will surpass that in the U.S. and after 9 more years will be significantly higher

Markets, Specialization, and Growth
- Markets, specialization, and the division of labor increase productivity and growth
  - Specialization is the concentration of individuals on certain aspects of production
  - Division of labor is the splitting up of a task to allow for specialization of production
- Markets may seem unfair because of the effect that they have on the distribution of income
- Even though growth isn't evenly distributed, it generally raises the incomes of the poor
Per Capita Growth

- Per capita output is total output divided by total population
- **Per capita growth** means the country is producing more goods and services per person
  - Per capita growth = \( \% \Delta \) in output - \( \% \Delta \) in population
- Some suggest that median income is a better measure because it takes into account how income is distributed