

## Lifting the Lid on Economic Growth

Professor Joe Nellis

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**Steve Macaulay**

Today we are going to look at the subject of economic growth. We are doing this in the studio with Professor Joe Nellis.

Now, Joe, economic growth seems such a complicated area; everybody says it is a good thing, and yet when you get too much of it people start to worry, when you get too little of it again people seem to worry. So let's try and unpack this – what on earth is it and what drives growth?

**Joe Nellis**

Well first of all let's give you the text book definition: it is an increase in the output of the economy. That is it. Growth is an increase in the output of the economy. Now, why is that important? Well I want you to imagine that the output is a cake, a large cake, and we are all going to share that cake. If the cake gets bigger, on average, we get a bigger slice so living standards go up. If the cake gets smaller, as in a recession, well then living standards fall.

So it really is as simple as that. Growth is what gives us the output that we then enjoy in terms of goods and services and therefore the income we generate, which we can then spend again on the output that we produce. So it is really quite important.

**Steve Macaulay**

Now is there a kind of, if you like, benchmark growth that we should all be aiming at? When I look round the world, China seems to be rocketing ahead; people are concerned, say in the UK, that growth is hardly there at all.

**Joe Nellis**

Well yes, it varies from country to country of course. What is sustainable is going to be different in different countries; but let me explain that in a non technical way.

Imagine you have got a large balloon to blow up; this is a developing economy. A large capacity – but the real problem is getting the balloon started, getting the economy growing initially. But once you have got growth beginning in an emerging market – a developing economy – then you get rapid growth. It gets easier to expand output, so China is growing at more than 10% because it has got lots of spare capacity. But as that balloon fills up, as economies mature, as they become old economies, it gets harder to sustain fast growth. And so growth moderates, perhaps down to 2.5, maybe 3% per year. That is the increase in the output of the economy, given its land, its labour, its capital, its technology. It is inevitable that as economies mature the rate of increase of the output slows down.

**Steve Macaulay**

Now governments seem to think they can do something about growth; are they right?

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**Joe Nellis** Well I hope they are right otherwise we have been very fortunate for the last few thousand years. The area of growth economics, or what is called supply side economics, is concerned with the government putting in place the right policies to create the right environment which will stimulate investment by companies, which will stimulate working by labour – by us – to create long term growth and output. So, yes, governments they have a massive role to play in creating the right incentives, the right culture in which we can stimulate investment, production, output of goods and services as well as people’s willingness to work. So it is really quite critical; they have a massive role to place.

**Steve Macaulay** Now Joe, I am a bit confused, a lot of government talk is about short term growth and yet when I talk to people like you, economists, you tend to talk much more about long term growth.

**Joe Nellis** Steve, that is quite easy to explain. Short term growth is about getting us out of recession; short term is about business cycles. Long term growth is much more important, in a sense. It is about increasing living standards and of course over a long period of time if we grow, let’s say 2.5% per year, we double living standards roughly every 28 years. So it is about quality of life in some ways, as opposed to short term recession recovery and so on.

**Steve Macaulay** So it is an incredibly complex area, growth; if you were to sum up some of the key essentials about growth, what would they be?

**Joe Nellis** Well first of all, we need to maintain innovation in the economy in terms of new technologies. Old machines eventually, well they break down, but their productivity doesn’t increase. So we need innovation. We need more R&D. We need also investment in people; people skills need to be developed to increase their productivity, as well as innovation. So capital investment, human investment and as well as land, of course, ultimately we need land to put the buildings where people are going to produce goods and services. So we need to utilise our resources, including land, more efficiently. And all of this comes under the heading, as I said, of growth economics or supply side economics and governments can of course support R&D, support technology, support investment in people – universities, for example – support better use of land, more efficiency. Very complex as you said Steve, but really this is the meaning of life in a sense; unless we grow we have to accept that living standards will not increase. And that is perhaps a different topic for a different day.

**Steve Macaulay** Some important messages in there Joe; thank you very much.

**Joe Nellis** Thank you.