

# The Importance of Economic Growth

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*“GDP grew at an annualized rate of 3.2 percent the Federal Reserve reported this morning. This is below economists forecast of 3.4 sending the DOW and the S&P lower at the open...”*

Sound familiar? While reports like that above come across the radio or television frequently what exactly do they mean? What is GDP? I'm not positive the news commentators themselves can define it so that's probably a good place to start.

GDP is Gross Domestic Product. Sounds complicated but it is actually just what it says it is: the value of all the finished goods in the U.S.

**Gross** (all) **Domestic** (from the United States) **Product** (i.e. finished goods)

There are two ways to measure GDP. One is to sum up the total of all the products that are made in a given year (all the cars, computers, etc.). The other is to sum up the income of everyone in the United States in one year.

So now that we have GDP defined what does it matter? If GDP shrinks by 1% or grows by 4% does it affect the way you live? It might, especially if GDP or more precisely your income is decreasing. If this is the case people are going to be loosing their jobs at a higher rate than normal and you might be one of the unlucky ones. While this seems obvious, what is most interesting is to look at the difference if GDP is growing by 2% or 4%. It may seem trivial but over the long run the impact is huge.

For our example let's look at the United States and Brazil. In the U.S. the average income is roughly \$30,000 and in Brazil it is currently around \$6,500. Where can we expect to be in 100 years? The tables below tell the story.

United States of America			Brazil		
GDP Growth	2000 Average Income	2100 Average Income	GDP Growth	2000 Average Income	2100 Average Income
5%	\$30,000	\$3,945,037.74	5%	\$6,500.00	\$854,758.18
4%	\$30,000	\$1,515,148.45	4%	\$6,500.00	\$328,282.16
3%	\$30,000	\$576,558.96	3%	\$6,500.00	\$124,921.11
2%	\$30,000	\$239,715.14	2%	\$6,500.00	\$47,090.20
1%	\$30,000	\$81,144.41	1%	\$6,500.00	\$17,581.29
0.5%	\$30,000	\$49,400.05	0.5%	\$6,500.00	\$10,703.35

As you can see with a low growth rate not much changes. If Brazil and the U.S. grow about 0.5% a year the average person will make \$10,703.35 and \$49,400.05 respectively. It is an improvement, but not much to write home about. On the other hand if the same countries were able to achieve a 5% annual rate the average Brazilian would be making nearly \$900,000 a year while the average U.S. citizen would be earning a cool four million annually. A 5% real growth rate isn't easy to come by but, looking at the chart, we see that even with a 3% growth rate Brazilians will be making on average over \$100,000. In the U.S. they will be making over a half million. Does this mean that the average Joe will have live like someone who makes a half-million a year today? The answer is no... they will live *better*.

While unbelievable upon first site there is no disputing the numbers. Perhaps though, the best way to convey this phenomenon is to look at our own history. The table below conveys the story:

<b>United States of America</b>		
<i>GDP Growth</i>	<i>1900 Average Income</i>	<i>2000 Average Income</i>
5%	\$4,000	\$526,005.03
4%	\$4,000	\$202,019.79
3%	\$4,000	\$76,874.53
<b>2.1%</b>	<b>\$4,000</b>	<b>\$31,962.02</b>
2%	\$4,000	\$28,978.58
1%	\$4,000	\$10,819.26
0.5%	\$4,000	\$6,586.67

In the year 1900 the average income in the United States was roughly \$4,000 in today's terms. As you can see from the table above we have averaged roughly 2.1% growth for the last 100 years. So we have had phenomenal growth in real income. If a family makes only \$4000 a year today they are extremely poor by our standards. Yet even they live much better than a family making the same amount in 1900. In fact they live in many ways better than the families considered rich at the time.

In 1900 life was hard if you were the average guy making \$4000 annually. It is true that they did not have many of the expenses that today many find common place. As we all know families in 1900 didn't own personal computers or have internet bills. Nor did they own cell phones or televisions. In fact only about 8% of households had electricity. This compares with over 99% of households today. So life was hard. But poverty at the time didn't just mean missing out on computer games and iced mochas... poverty meant death. Not even the rich could escape its claws.

Life was hard for both rich and poor. To compare the quality of life a good place to start is the average lifespan at the turn of the century, which was 47. Today, thanks largely to modern medicine and less strenuous labor, we have added another 30 years to this figure and it's still rising. One child in every 10 died before their first birthday in 1900. Today that figure is 1 in 150. On top of this none could hide from horrifying diseases such as polio, plague, tuberculosis, and whooping cough. This list goes on.

Sadly much of the world still lives in this poverty that was widespread at the turn of the century. Being born on the wrong side of a border can mean a life even worse than that of our country at the turn of the century. There are one hundred years of progress that too many in this world cannot take a part in. Fortunately we do have a solution... economic growth.

As shown from the tables above with economic growth the poor of yesterday can be the rich of tomorrow. Economic growth does matter... What creates it is a subject for another paper.