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Is there a conflict between allocative efficiency and economic growth? Yes or No? Why or why not?

Allocative efficiency is a measure of whether maximum possible surplus has been acquired for all stakeholders; often this is both consumers, produces, and government spending or revenue. While touted as the most optimum, the only way economic growth can happen in the model of allocative efficiency is when more capital is purchased, i.e. more firms enter the market and there are more goods produced, due to increasing demand, etc. In real life, however, economic growth often happens due to technological innovation, where firms invest not in capital but in R&D, which can produce long-term benefits as the externality of the “good ideas” that such investments can produce—which come from a surplus of profit that can be invested as such. Good ideas increase the productivity of capital and/or labor, and increase to the total sum value added to the economy.

In a hypothetical allocatively efficient market, there is little incentive to invest in the production of good ideas, as such perfectly competitive firms are making zero profit, or else they will exit the market in the long-run. Thus the lack of the surplus of economic profit that can be directed into value creation by productivity or differentiation, leads to the inevitable conclusion that allocative efficency cannot lead to economic growth.

(212 words)