

Chapter 2

October-29-11
4:21 PM

- All economies in the world today are mixed economies
- All have specific mixture of private/public production and consumption of goods and services
- Private/public composition of goods and services reflects policy preferences of governments that have been fashioned by the history of each country
- Over time, the structure of output in an economy changes primarily because of political forces at work in reshaping those preferences
- Canada's uniqueness is its continued large public sector with close to 1/4 of total production flowing from public sector activities, thereby making it a mixed economy *par excellence*
- **Gross Domestic Product (GDP)** - a measure of the size of the economy - the total amount is produced a year
- **Real GDP** - adjusts this measure for changes in the purchasing power of money - that is corrects for inflation
- Government purchases account for about 22% of GDP, but most purchases are from private businesses

A Relatively "Open" Economy

- Economic history of Canada has been shaped by foreign trade
- From the time of the first European contact, Canada was integrated into the world economy by establishing itself solidly as a producer of primary products and an importer of manufactured goods
- In 2007, Canada's annual exports were about \$535 billion and imports about \$503 billion
- Fact is we still produce a large portion of what we consume and consume a great deal of what we produce
- Myth that this country is no longer manufactures anything, but rather imports everything from, say low-wage China. About 33% of Canada's GDP was imported in 2007
- Less than 10% came from China, thereby reflecting about 2.5% of GDP
- **Open Economy** - called so if it exports and imports constitute a large share of its GDP
- **Closed Economy** - if exports and imports constitute a small share
- Canada is considered a moderately open economy
- Canada's real GDP *per capita* was about three times higher in 2007 than in 1959 - living standards have tripled in less than half a century

But With Bumps Along the Growth Path

- **Economic fluctuations (business cycles)** - alternating periods of good and bad times
- Two major ones since 1980 - GDP actually declined
- **Recessions** - a period of time during which the total output of the economy falls, declining economic activity
- **Growth rate** - the percentage of change from one year to the next
- We had fairly sustained growth from the mid-1950s to the mid-1970s
- Over the last quarter of the century, Canada went through two severe recessions - in both cases severe enough to have contributed to the defeat of the governments in power
- In early 1980s, Canada went through what some of them dubbed as a "great recession" - in an economic slump important enough to have helped defeat Turner's Liberals in 1984
- One important consequence of these ups and downs in economic growth is that unemployment varies considerably from one year to the next

THE INPUTS: LABOUR AND CAPITAL

- Most important is human labour
- Out of slightly over 33 million Canadians, about 17 million (or about half of the population) held jobs in 2007
- In 1950, just 22 percent of women worked in the marketplace; now about 63 percent do
- Percentage of teenagers in workforce has dropped since peak in mid-1970s - 10.9% in 1974 and only 5.8% in 2006

The Canadian Workforce: What Does It Do?

- Majority of workers produce services, not goods
- In 2007, about 76% of all workers in Canada were employed in the service sector with vast majority in private service jobs
- All industrialized countries have become "service economies"
- Can be attributed to at least 2 fundamental causes:
 1. As household real income has risen over time, a growing proportion of household spending has shifted toward consumer services and away especially from primary sector's output that fulfills some of our most basic needs
 2. Also been made possible by the growing efficiency of production resulting from the large-scale introduction of labour-saving technology in goods producing sector of economy
- May be argued that "services revolution" has also occurred with the arrival of the Information Age

The Canadian Workforce: What It Earns

- When taken together, workers wages account for over 60% of total income that the production process generates in Canada
- Hourly wage of approx. \$20 and weekly wages of \$750 before taxes
- In 2001 census, it was found that workers holding a university degree earned 91% more on average than those holding high school certificate

Capital and Its Earnings

- Rest of national income mainly accrues to owners of **capital** - the machines and buildings that make up the nation's industrial plant
- Total market value of business assets is approx. \$3.5 trillion
- Total capital earnings comes to about \$250 billion - corporate profits constitute approx 2/3 total earnings while rest is mainly interest income
- Profit accounts for about 7 percent of the price of a typical product

THE OUTPUTS: WHAT DOES CANADA PRODUCE?

- Consumer spending accounts for about 60% of GDP
- Households spend roughly 60% of budget on services, with housing taking the largest share
- Leaves about 40% of GDP for all non-consumption uses - government services (hospitals, schools, etc...), business purchases of industrial nature, and consumer purchases of new houses

THE CENTRAL ROLE OF BUSINESS FIRMS

- When looking at what turns inputs into outputs, see mainly private companies whose principal objective is pecuniary gain
- Owners and managers of businesses hire people, acquire or rent capital good, and arrange to produce things consumers want to buy
- 2.5 million active business establishments in Canada - 7000 businesses fail every year
- Estimated that only one out of ever five firms survives after only ten years of existence in Canada
- High turnover of business enterprises in a market economy was described as a process of "creative destruction" (Joseph A. Schumpeter)
- Foreign-based multinational corporations doing business in the Canada - country's mainly been on the receiving end of foreign direct investment

- Practically impossible to determine true nationality of a corporation - may have factories in one country, sell wares all over the world, and stockholders elsewhere
- Firms compete with other companies in their industry - competition is key to industrial efficiency

WHAT'S MISSING FROM THE PICTURE? GOVERNMENT

- Capsule summary of how Canadian economy works:
 - 2.5 million private businesses, energized by profit motive
 - Employ about 17 million workers and about \$3.5 trillion of the capital
 - These firms bring their enormously diverse wares to market, where they try to sell them to over 33 million consumers
- Firms use receipts from sales to pay wages to employees and interest and profits to people who provide the capital
- These income flows, in turn, enable consumers to purchase goods and services that companies produce
- Linked to a series of interconnected markets
- Traditional role of government in market economy revolves around five jobs:
 1. Making and enforcing the laws
 - Government enters as a rule maker, referee, and arbitrator
 - Federal Parliament and provincial and local governments pass the laws that define the rules of the economic game
 - All three levels share responsibility for enforcing them
 2. Regulating business
 - Must interfere in market (i.e. to protect consumers from misleading advertising, regulating use of hazardous products)
 - Market economies are vulnerable to abusive and detrimental market practices - governments have often introduced competition legislation in order to make markets work
 - Canada's federal *anti-combines legislation* is there to protect competition against encroachment by monopoly
 3. Providing certain goods and services such as national defence
 - Most contentious issues often involve taxing and spending
 - Fiscal imbalances - caused by government turnaround from huge deficits to surplus
 - Spend on social services, and programs including pensions and income security
 - On health care, on protection (national defence)
 4. Levying taxes to pay for these goods and services
 - Government spends, thereby injecting money into the market system - it also withdraws money from economy when it collects taxes
 - Net spending - difference between what government spends and what it receives in tax revenues
 - By international standards, Canadians aren't overtaxed
 5. Redistributing income
 - In market economy, people earn incomes according to what they sell
 - Two basic remedial approaches to redistributing:
 1. Socialist idea is to force the distribution of income to be more equal by overriding the decisions of the market
 2. For economists, idea is to let free markets determine the distribution of *before-tax* incomes but then to use tax system and **transfer payments** to reduce inequality - rationale for **progressive taxation** and welfare
 - **Transfer Payments** - sums of money that certain individuals receive as outright grants from the government rather than as payments for services rendered
 - **Progressive Taxation** - a tax is progressive if the ratio of taxes to income rises as income rises

CONCLUSION: IT'S A MIXED ECONOMY

- **Mixed Economy** - one with some public influence over the workings for free markets. There may also be some public ownership mixed with private property