

Canadian and global Economies

Objectives

Describe what, how, and for whom goods and services are produced in Canada

Use the circular flow model to provide a picture of how households, firms, and governments interact

Describe the macroeconomic performance—standard of living, cost of living, and economic fluctuations—of the Canadian and other economies

What do we produce?

In macroeconomics, we divide the vast array of goods and services produced into four large groups:

- Consumption goods and services
- Investment goods
- Government goods and services
- Exports of goods and services

Consumption Goods and Services

Consumption goods and services are items that are bought by individuals and used to provide personal enjoyment and contribute to a person's standard of living. They include items such as housing and furniture, clothing, SUVs, movies and popcorn, vacation trips, coffee and doughnuts, dental care, and dry cleaning services.

Investment Goods

Investment goods are goods bought by businesses to increase their ability to produce goods and services. They include items such as auto assembly lines, machinery and equipment, gas pipelines, banks' computers, and shopping malls.

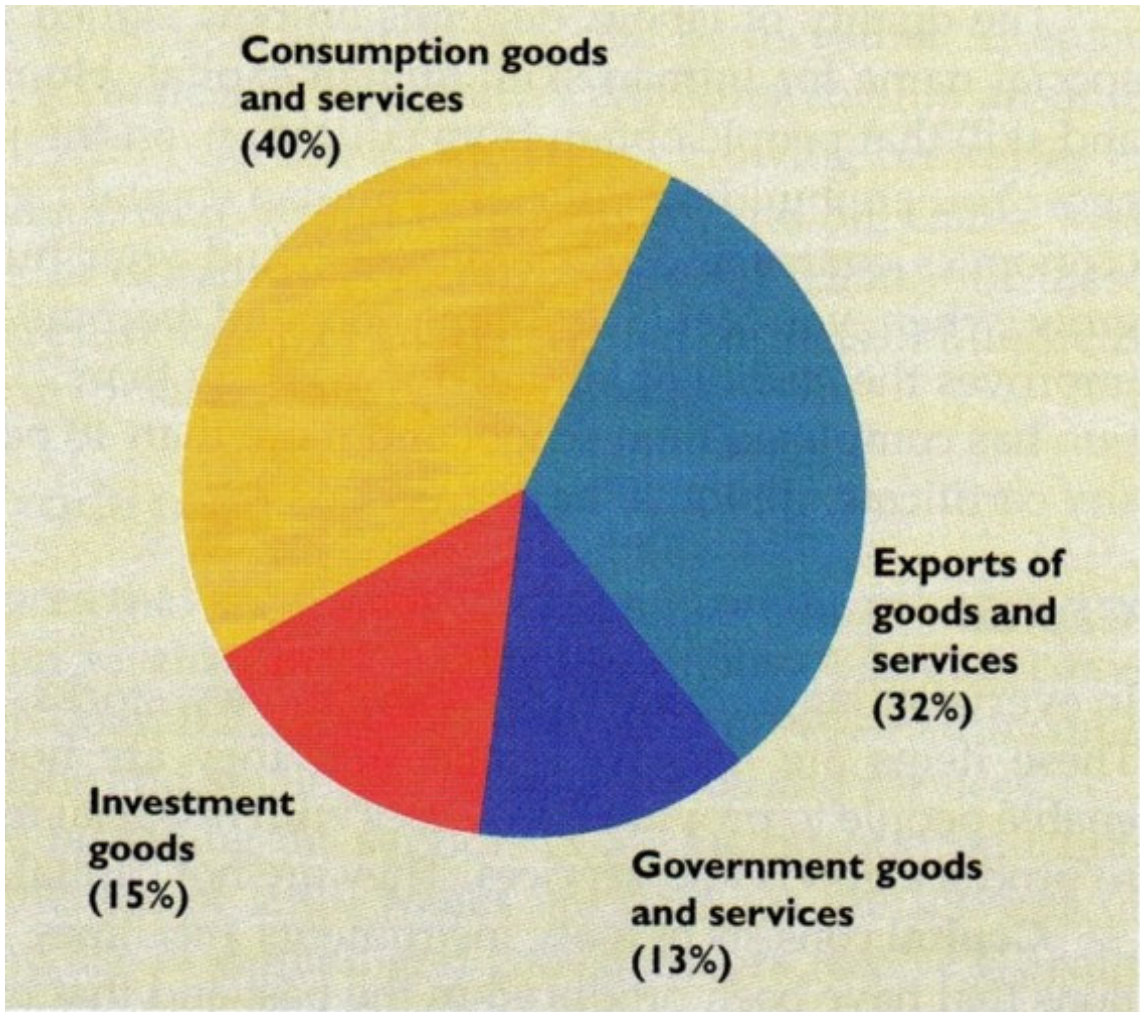
Government Goods and Services

Government goods and services are items that are bought by governments. They include items such as health care, education, police protection, law courts, computers, and military equipment.

Exports of Goods and Services

Exports are goods and services produced in Canada and sold in other countries. They include the railway locomotives that General Motors make in London, Ontario that the Irish government buys and the Canada Regional Jets that Bombardier makes in Quebec and that Ansett Airlines of Australia buys.

Figure 2.1 provides a snapshot of the division of total production in Canada in 2000 into these four groups. You can see that the largest component was consumption goods and services, while government goods and services were the smallest. The figure also highlights the large size of exports, which is a key feature of the Canadian economy.



SOURCE: Statistics Canada.

How do we produce?

Using factors of production.

- Land
- Labour
- Capital
- Entrepreneurship

Land

Land is natural resources” It includes land in the everyday sense, minerals, energy, water, air, wild plants, animals, bird, and fish.

Labour

Labour is the work item and work effort that people devote to producing goods and services.

Capital

Human capital

The knowledge and skill that people obtain from education, on-the-job training, and work experience.

Capital

Tools, instruments, machines, buildings, and other constructions that have been produced in the past and that businesses now use to produce goods and services.

Entrepreneurship

The human resource that organizes labour, land, and capital.

For whom do we produce?

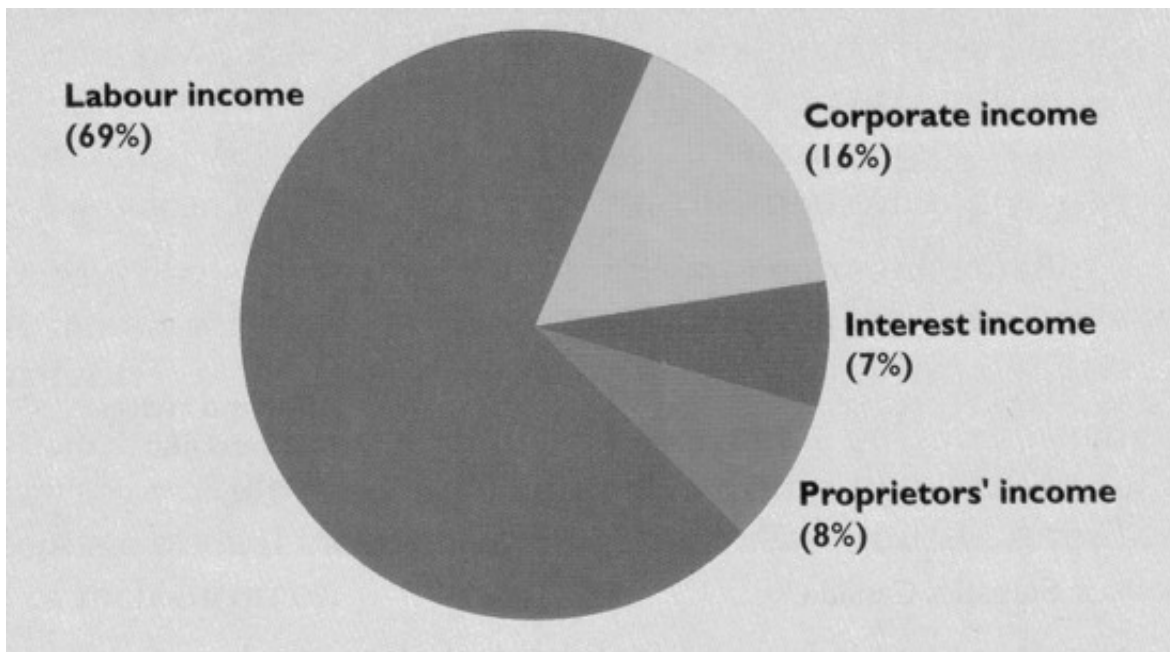
Rent: income paid for the use of land

Wages: income paid for the services of labour.

Interest: income paid for the services of labour.

Profit (or loss): Income earned by an entrepreneur for running a business.

Functional distribution of income: the percentage distribution of income



Circular flows

Circular flow model

A model of the economy that shows the circular flow of expenditure and incomes that result from decision maker's choices, and the way those choices interact to determine what, how, and for whom goods and services are produced.

Households

Individuals or groups of people living together as decision-making units.

Firms

The institutions that organize the production of goods and services

Market

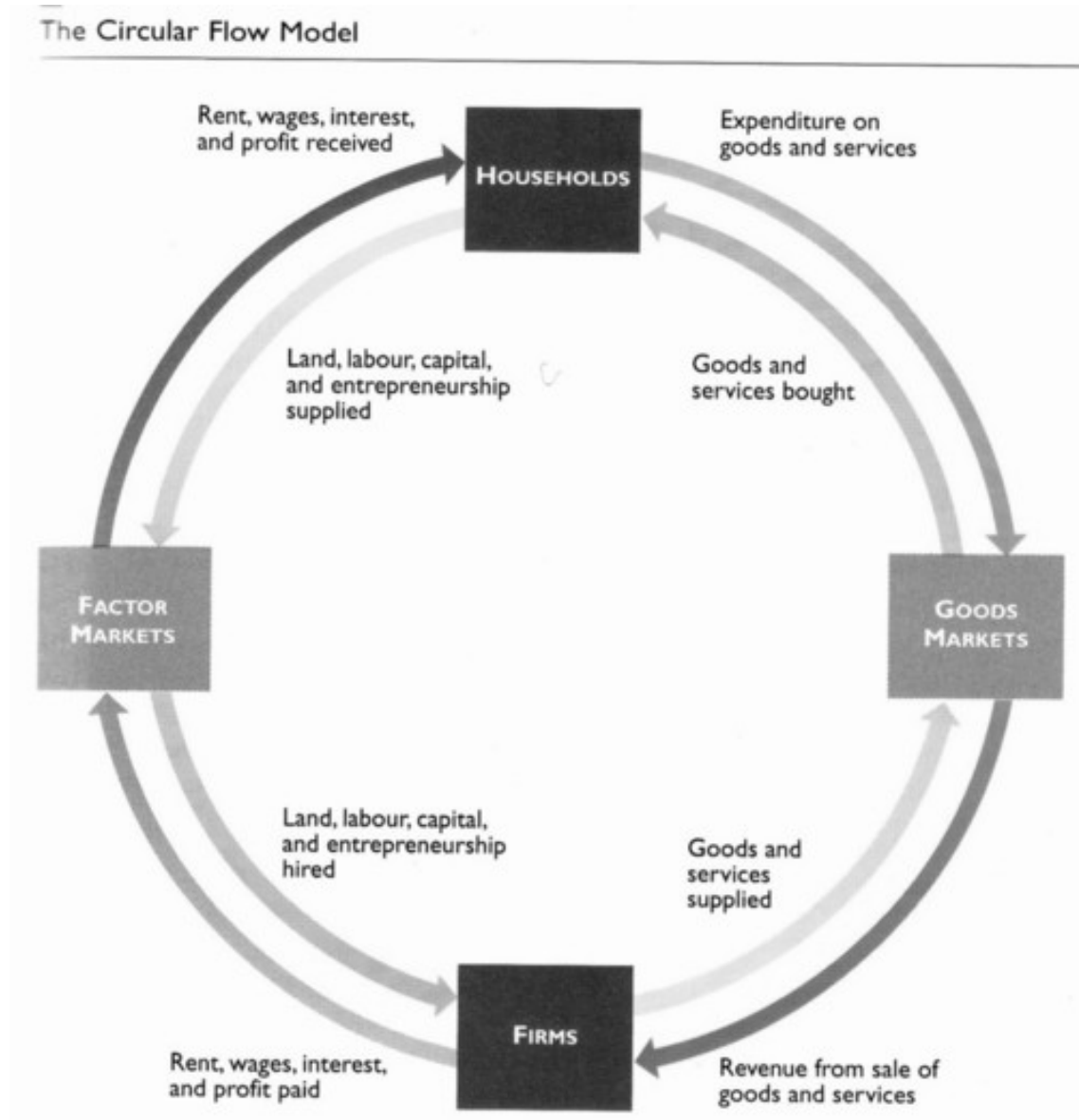
Any arrangement that brings buyers and sellers together and enables them to get information and do business with each other.

Goods markets

Markets in which goods and services are bought and sold

Factor markets

Markets in which factors of production are bought and sold.



The government sector

- Federal government
- Provincial government

Federal government

Major payments (outflow)

- Expenditures on goods and services
- Transfers to persons
- Transfers to provincial and local government

Collection of taxes(inflow)

- Personal income taxes
- Corporate(business)income taxes
- GST and excise taxes

Provincial and local government

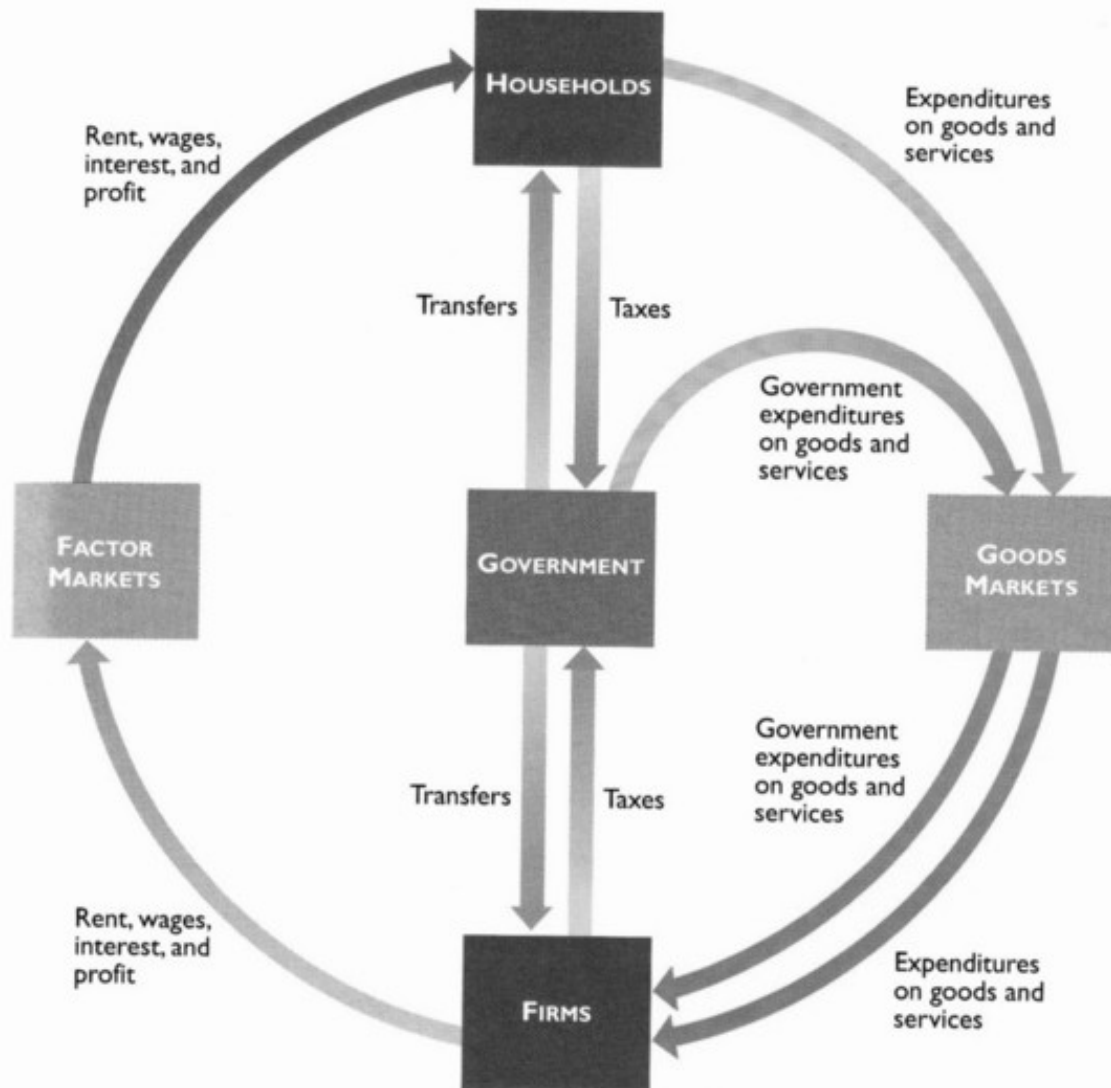
Major payments(outflow)

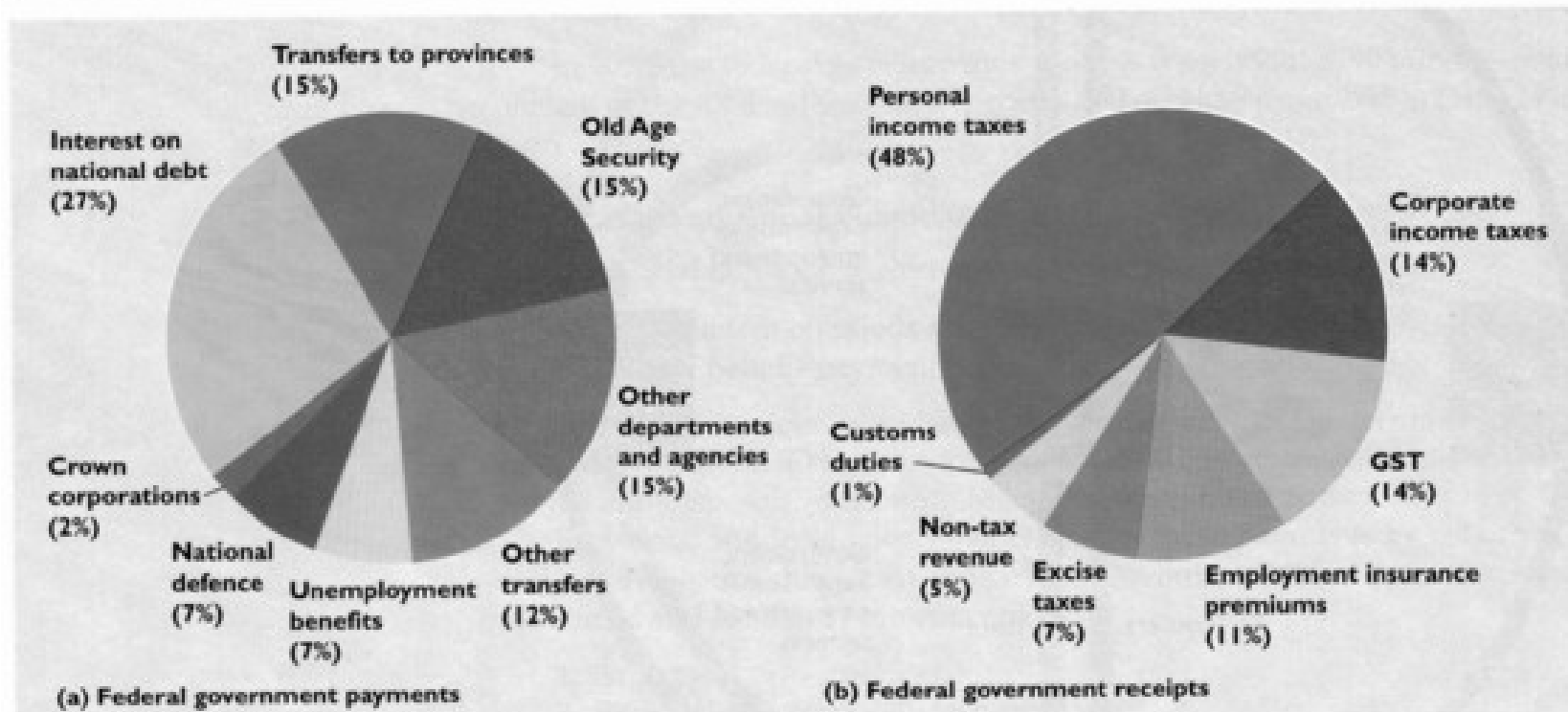
- Expenditures on goods and services
- Welfare benefit payments

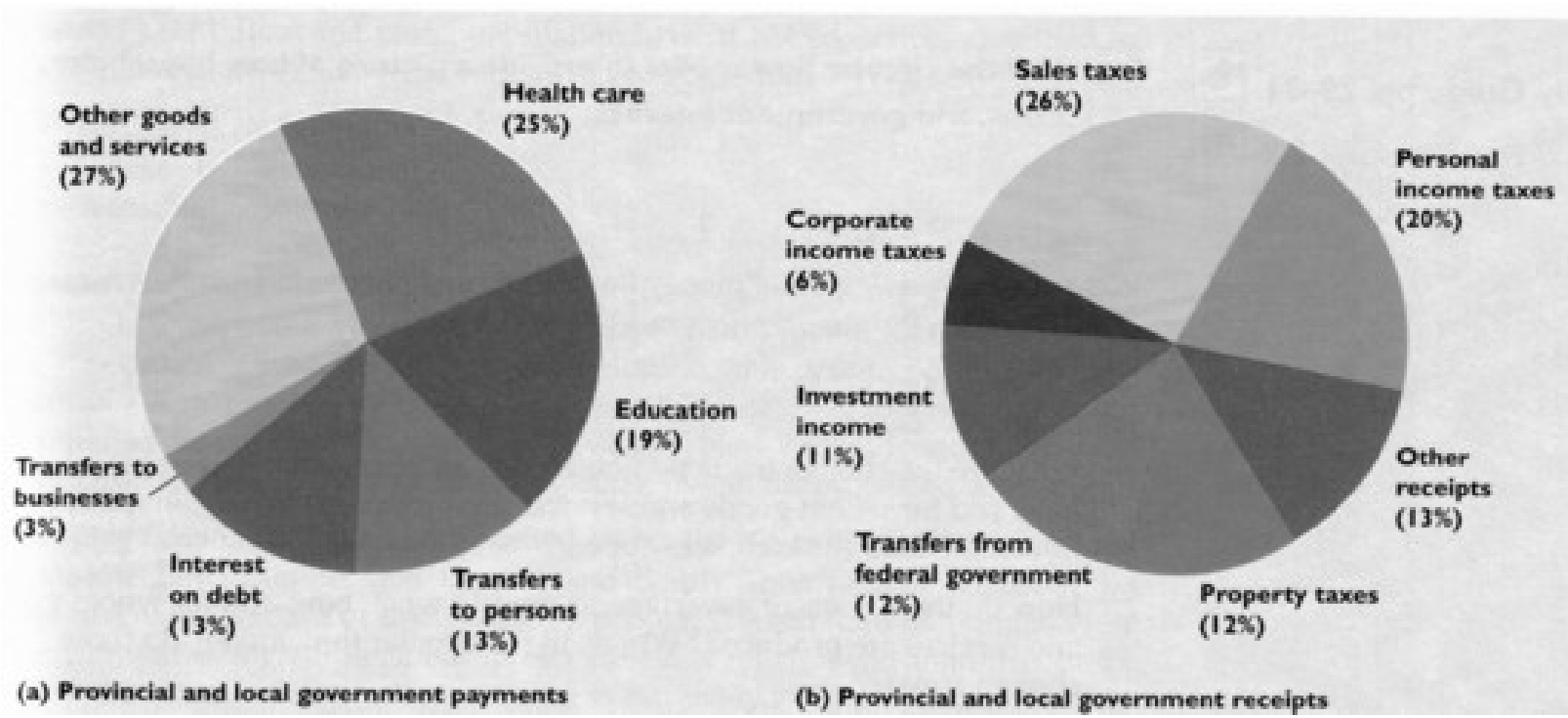
Collection of taxes(inflow)

- Sales taxes
- Personal and corporate income taxes
- Property taxes

Government in the Circular Flow







Macroeconomic performance

Three dimensions

- Standard of living
- Cost of living
- Economic fluctuations

Standard of living

The standard of living depends of the quantities of goods and services produced and the number of people among whom those goods and services shared.

The greater the value of production per person, the higher is the standard of living.

Classification of countries

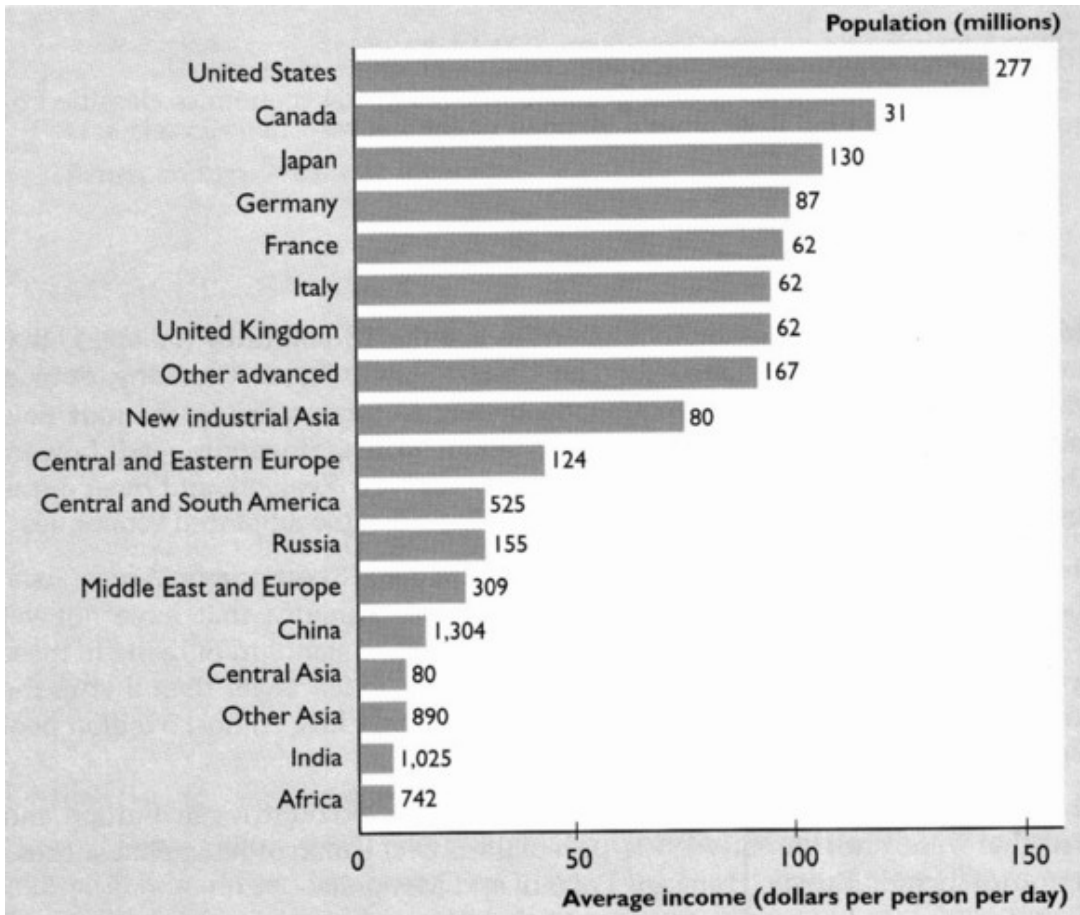
Three broad groups

- Advanced economies
- Developing economies
- Transition economies

Living standards around the world

In 2000, average income per person ranged from \$140 per day in the United States to \$7 a day in

Africa. The world average was \$30 per day, and Russia and Central and South America were close to the world average.



Unemployment and living standards

Unemployment is another factor that influences the standard of living.

Cost of living

The cost of living is the amount of money it takes to buy goods and services that a typical family consumes.

The Hamburger Standard (based on Jan 15, 2003 data)

Country	BigMac Price		Actual Exchange Rate 1 USD =	Over(+) / Under(-) Valuation against the dollar, %	Purchasing Power Price
	in Local Currency	in US dollars			
United States	\$2.65	2.65	1.00	-	-
Argentina	Peso 3.85	1.2612	3.0526	-52.4995	1.45
Australia	A\$3.20	2.4646	1.2984	-12.1996	1.14
Brazil	Real 4.50	1.7218	2.6135	-34.9531	1.70
Britain	£1.99	3.7294	1.8741‡	40.5547	0.75
Canada	C\$3.20	2.5606	1.2497	-3.1768	1.21
China	Yuan 9.95	1.2007	8.2865	-54.7457	3.75
Euro area	€2.75	3.5361	0.7777	32.4418	1.03
Hong Kong	HK\$11.25	1.4424	7.7993	-45.6361	4.24
Hungary	Forint 492	2.5897	189.98	-2.095	186
Indonesia	Rupiah 16,155	1.7543	9208.9	-33.8032	6,096
Japan	¥263	2.5199	104.37	-4.7619	99.40
Malaysia	M\$5.10	1.342	3.8003	-49.4777	1.92
Mexico	Peso 22.0	1.9717	11.158	-25.6139	8.30
New Zealand	NZ\$3.95	2.8042	1.4086	5.7788	1.49
Poland	Zloty 6.30	2.0388	3.09	-22.9773	2.38
Russia	Rouble 40.00	1.4223	28.123	-46.3429	15.09
Singapore	s\$3.30	2.0203	1.6334	-24.0847	1.24
South Africa	Rand 14.05	2.2689	6.1923	-14.4098	5.3
South Korea	Won 3,211	3.136	1023.9	18.2733	1,211
Sweden	Skr 30.0	4.2483	7.0616	60.3036	11.32
Switzerland	SFr 6.35	5.2384	1.2122	97.9871	2.40
Taiwan	NT\$70.55	2.2301	31.635	-15.8527	26.62
Thailand	Baht 55.0	1.4344	38.344	-45.8846	20.75

‡ Dollars per pound

Purchasing Power Parity (PPP): is a measure of the relative purchasing power of different currencies. It is measured by the price of the same goods in different countries, translated by the FX rate (or exchange rate) of that country's currency against a "base currency".

How to read this table:

In this case, the goods is the Big Mac. For example, if a BigMac costs €2.75 in the countries that use Euro and costs \$2.65 in US, then the PPP exchange rate would be $2.75/2.65 = 1.0377$.

If the actual exchange rate is lower, then the BigMac theory says that you should expect the value of the Euro to go up until it reaches the PPP exchange rate. If the actual exchange rate is higher, then the BigMac theory says that you should expect the value of the Euro to go down until it reaches the PPP exchange rate.

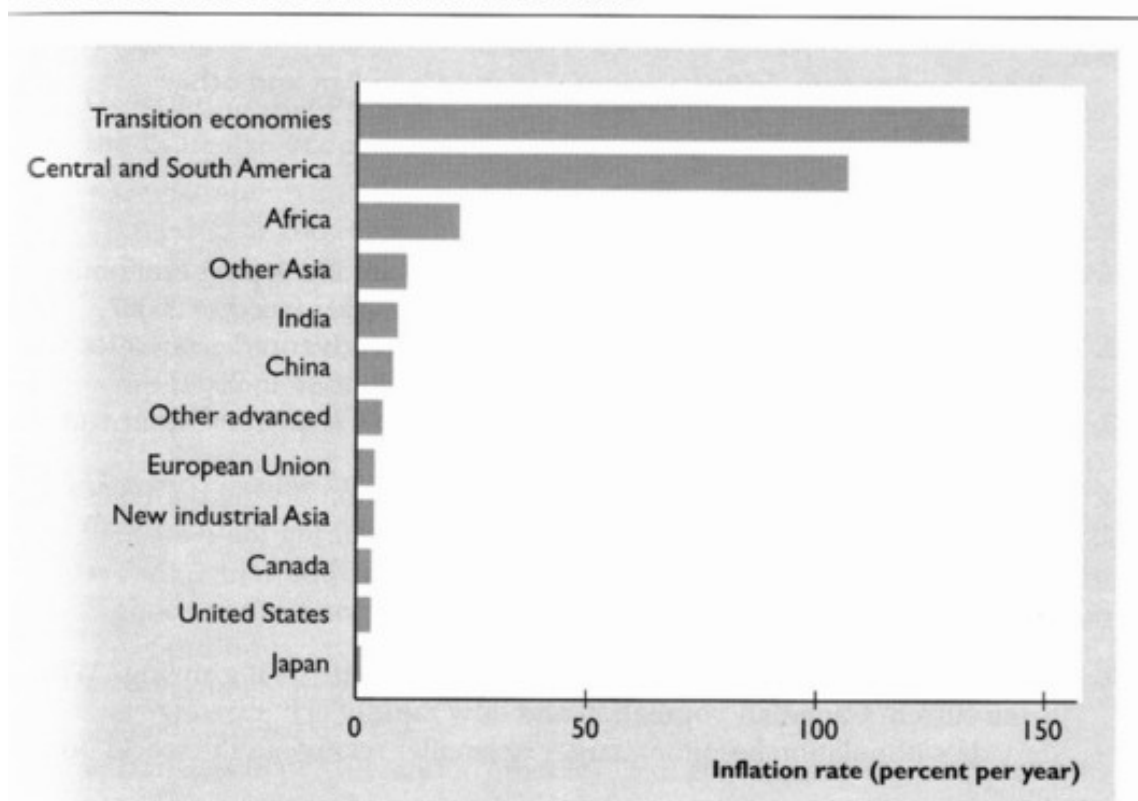
The Over/Under valuation against the dollar is calculated as:

$$\frac{(\text{PPP} - \text{Exchange Rate})}{\text{Exchange Rate}} \times 100$$

Inflation

The number of units that something costs is not very important, but the rate at which it is changing is. A rising cost of living is called inflation, which is measured by the percentage change in the cost of living.

Inflation Rates Around the World: 1982–2000

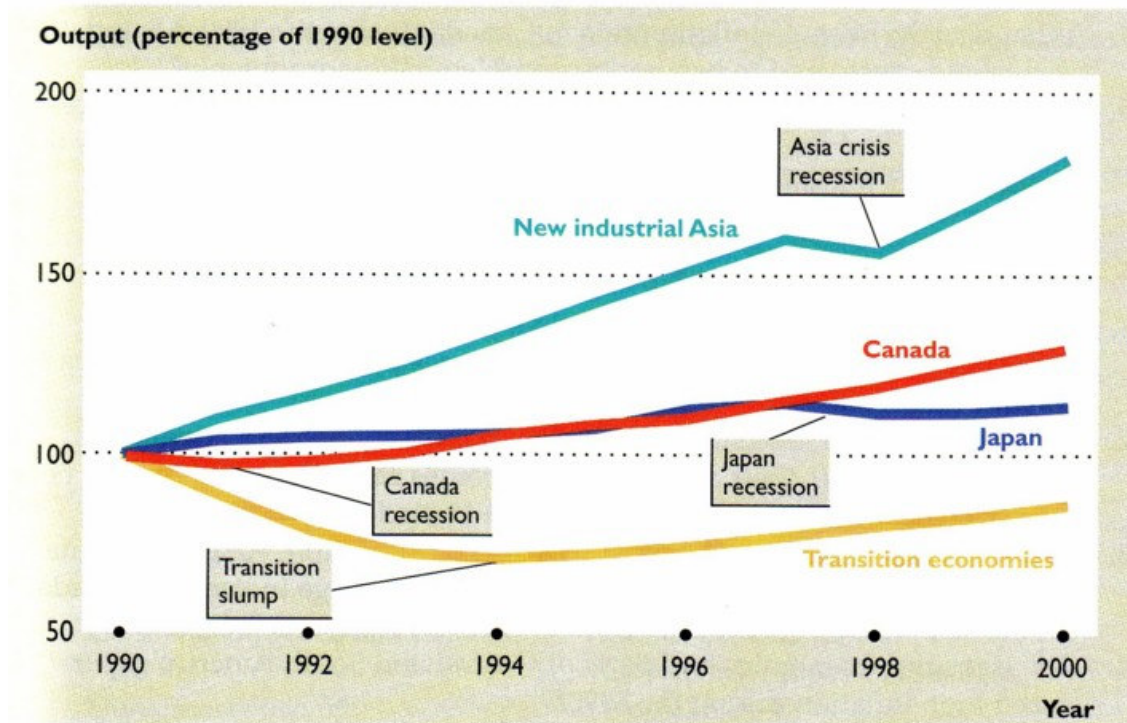


SOURCE: International Monetary Fund, *World Economic Outlook*, October 2000, Washington, D.C.

Economic fluctuations

Economies expand at an uneven pace and sometimes shrink.

Business Cycles in the Global Economy



SOURCE: International Monetary Fund, *World Economic Outlook*, October 2000, Washington, D.C.