

BASIC ECONOMIC QUESTIONS AND ECONOMIC SYSTEMS

The Basic Economic Questions

- Because of Scarcity, there are three basic questions any society must answer:
 - What to produce?
 - How to produce?
 - For whom to produce?

What to Produce?

- Countries face economic choices when trying to decide what items to produce.
- What goods and services should our society produce, and in what quantities?
- What is worth producing and what is not?
- What are we giving up in order to produce these goods and service?

- The PPC is a perfect example of this process.
 - They must decide how much of each possible good and service is to be supplied.
 - Should these decisions be based on past practices, the individual choices of consumers, or government decisions?

How to Produce?

- Once they've answered what to produce, they must decide how it should be produced
- By whom, with what resources and in what way should goods be produced?
- How much automation should be used? How much manual labour?
 - Ex: Should farmers use horse-drawn plows and large amounts of labour to produce wheat? OR Should they use sophisticated farm machinery and very little labour?

- How can our limited resources be used most efficiently?
- Should products be made in small, privately owned factories or in a large, state-owned corporation?

For Whom to Produce?

- A country must also determine how its total output of goods and services will be distributed.
- How will total output be shared among the different members of society?
- Who will get which goods and services? Will products be shared equally?
- On what basis should decisions concerning distribution be made?

Economic Systems

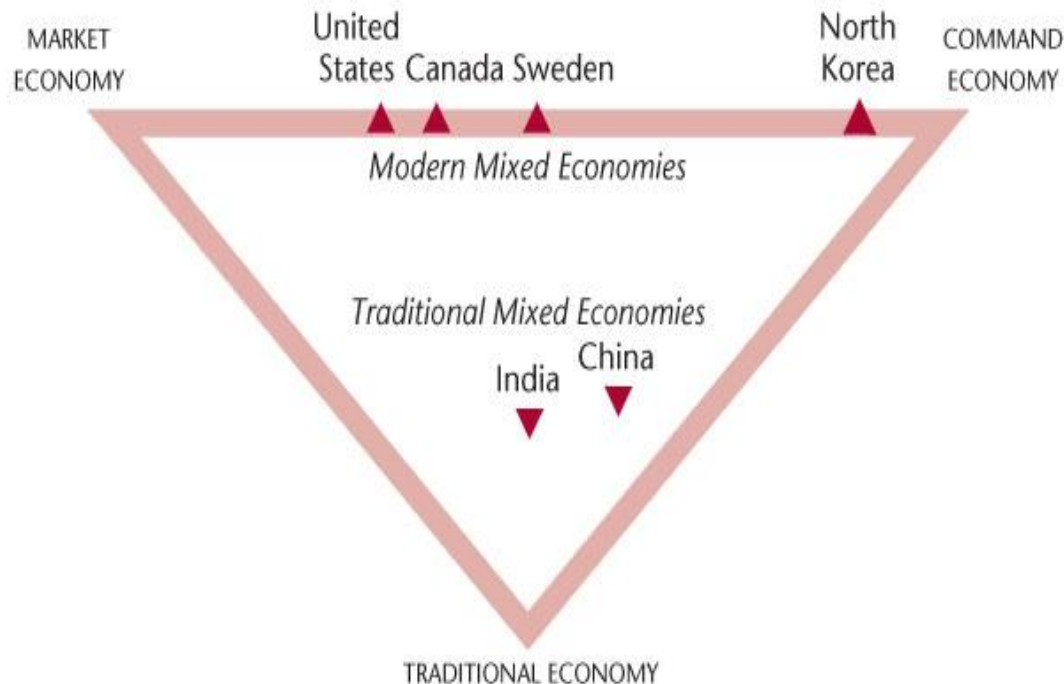
- To answer these three basic questions, a country organizes their economy
- The result is their economic system
 - Set of laws, institutions, and common practices that help a nation determine how to use its scarce resources to satisfy as many of its people's needs and wants as possible.

Economic Systems

- There are three systems to choose from:
 - Traditional economy
 - Command economy
 - Market economy
- Most economies are mixed, they combine aspects of the main economic systems
- These systems are all founded on different views of what a society's primary aims should be

The Range of Economic Systems

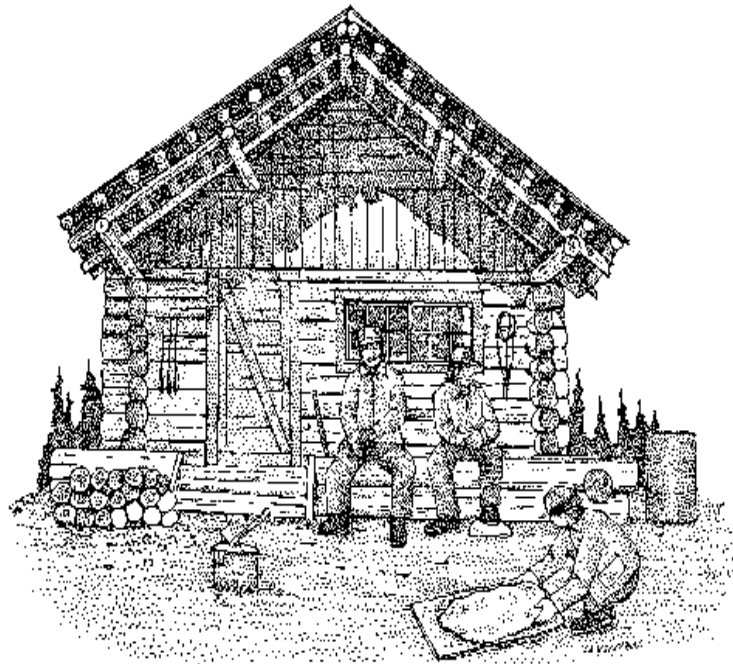
FIGURE 1.4 The Range of Economic Systems



Real-world economies can be positioned on or within a triangle whose points make up the three basic types of economic systems: traditional, market, and command. Countries with surviving traditional sectors combine them with emerging private and public sectors (as in China and India).

Traditional Economy

- All economic decisions based on historical traditions.
- Goods & services today are the same as those produced in the past and the manner of production has not changed.



- Practices and skills are passed on from generation to generation, usually within the same family.
- Output doesn't vary much
- Usually found in a relatively static subsistence where people don't do much long term planning and focus primarily on survival.

- What to produce?
 - Determined by the needs of the family
 - Surplus is usually traded for other essentials
 - Trading known as **Barter**
- How to produce?
 - Parents teach children necessary skills
- For whom to produce?
 - For their own use

- Centuries ago this was the most common economic system
- Today, traditional economies (with varying degrees of modification) are found within some societies:
 - Ex: The Bedouin of the Sahara Desert and the Yanomami of the Amazon rain forest
- Modern communication and technologies have exposed once isolated economies to more ideas and information.
 - Ex: Indigenous populations in Canada

Advantages

- Minimal change
- Decisions made as a family unit
- Little damage to the natural environment
- Consumption and waste minimized

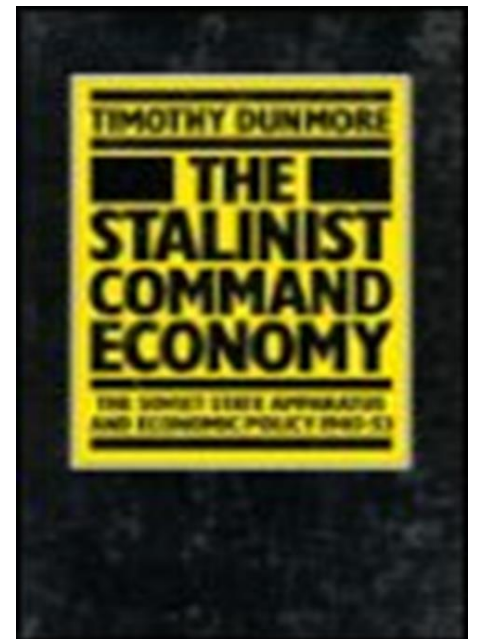
Disadvantages

- Little opportunity for social improvement
- No monetary system
- Little long-term planning
- Limited quality, quantity and variety of goods
- Individualism is discouraged

Command Economy

- All economic decisions are centrally planned.
- All production decisions are made by a small group of political leaders who have the power to enforce their decisions throughout the entire economy.
- State authorities draw up plans to meet individual needs such as food, housing, medicine and education.
- The individual person has the obligation of serving the state.

- What to produce?
 - Determined by central authority
- How to produce?
 - Determined by central authority in the state's best interest
- For whom to produce?
 - Determined by central authority



- Rely on the system of reward and punishment to promote increased productivity.
 - Rewards people who contribute to the betterment of the state by giving them a share of goods and services.
 - Penalizes people who do not contribute.
- The state plan emphasizes the production of capital goods over consumer goods.
 - Capital goods increases the economy's ability to produce more in the future.
 - Consumer goods are generally in short supply.

Advantages

- Planning promotes growth and reduces waste
- Equitable distribution of income and wealth
- Planning provides stability
- Individuals serve the state and the state provides for their needs

Disadvantages

- Bureaucratic and inflexible
- Limits individual choice, incentive and initiative
- Forced to meet production quotas (quantity over quality)
- Limited availability of consumer goods

Market Economy

- A decentralized economy where decisions are made by consumers and producers.
- This system is ruled by the concepts of Demand and Supply.
 - If Demand increases then Supply will increase.
 - If Demand decreases then Supply will decrease.



- What to produce?
 - Determined by the consumer.
 - What will sell for the most favourable price.
- How to produce?
 - Decided by the producers.
 - As efficiently as possible to keep production costs low
- For whom to produce?
 - Determined by income levels.
 - Consumers willing and able to pay a favourable price.

- The basic elements of a market economy are:
 - Private property
 - Freedom of enterprise
 - Profit maximization
 - Competition
- The government's role is only to provide law and order and to assist economic development.

Advantages

- Maximum freedom of individual choice
- Variety of goods and services available
- Competition helps keep quality high and prices low
- Profit motive provides incentive to be efficient

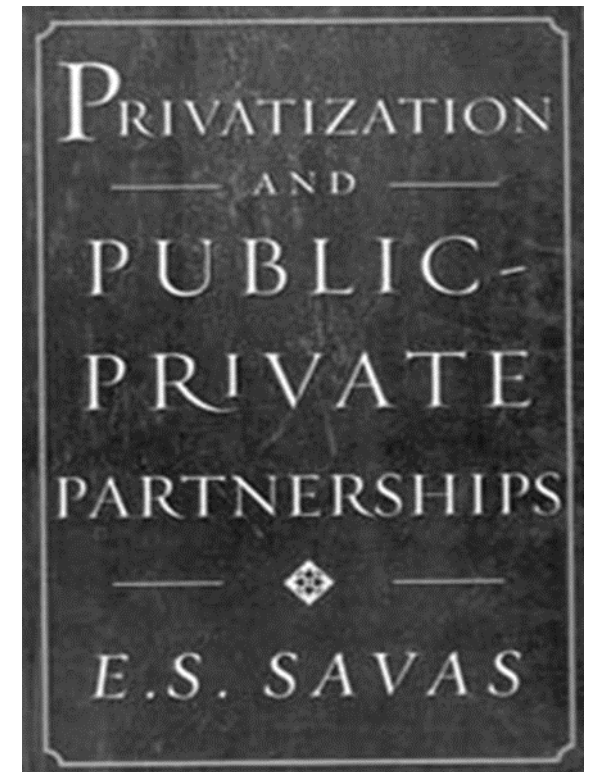
Disadvantages

- Manipulation of consumer wants by advertising
- Income and wealth unevenly distributed
- Large produces can influence price
- Over-consumption can cause resources to run out

Mixed Economy

- Most countries follow a combination of command and market economies.
- Government provides major services to the public.
 - Health care, education, public transit, police
- Government provides services in the following manners:
 - People pay out of taxes and the government purchases the services on the public's behalf (Education).
 - Government Operates enterprises that provide services (Crown Corporations – ex: CBC).
 - Government subsidizes the cost to make the cost to the user lower (Public Transit).

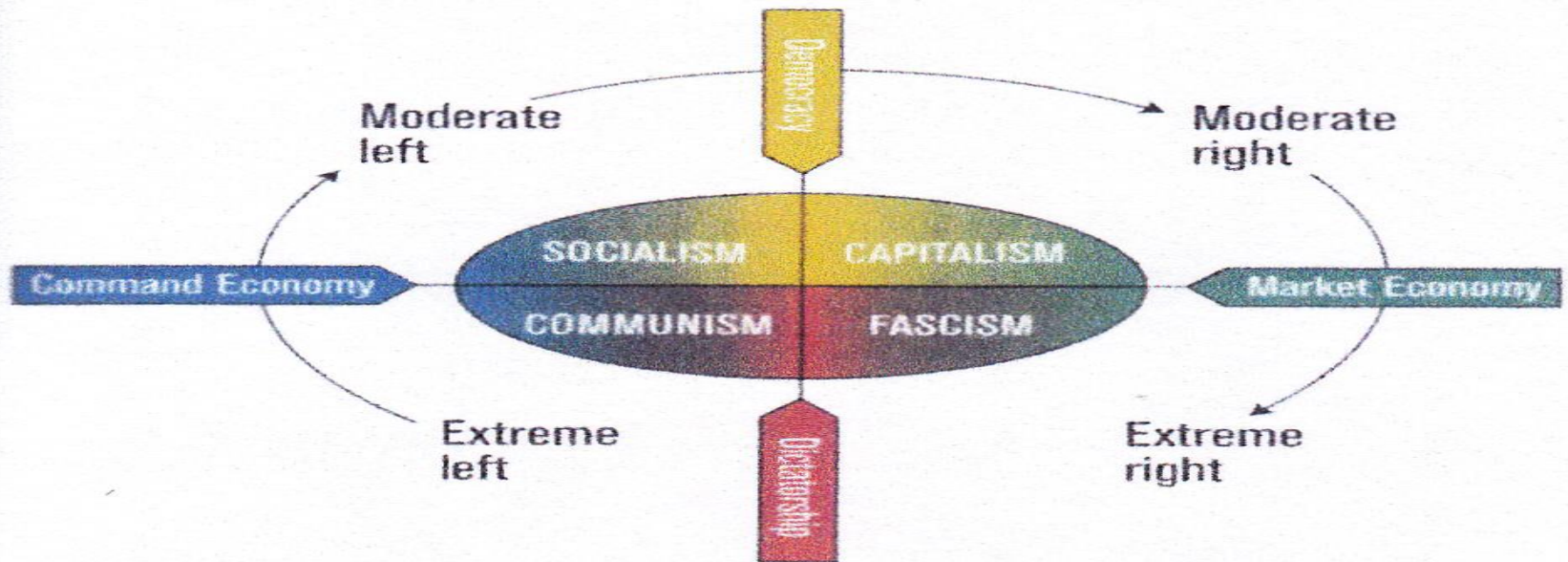
- Government regulates business operations and practices.
 - Employment standards, safety standards, regulate prices
- Government redistributes income.
 - Employment insurance, welfare, pensions, tax credits



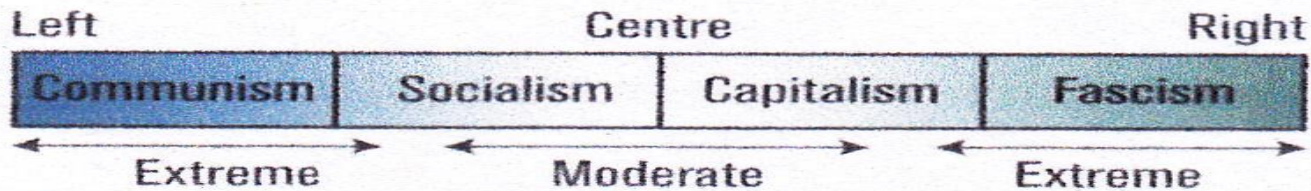
Political Economies

- Democracy means political system involves freely elected government and allows differing political views
- Dictatorship involves a single person or party having authority over a nation

Political Spectrum



Political Orientation



Political Economies

Communism:

- the “left”
- government owns control of all means of productions
- no private property rights
- can use violence to retain power



Political Economies

C. C. F.
STANDS FOR
SOCIALISM

G. H. Williams said in the Legislative Assembly on November 19, 1934:

"The gentlemen to your right, the Liberals, will hardly deny that they are supporters of an economic system known as Capitalism, and that they believe a solution to our economic ills can be found within the orbits of that system. We on your left, the C.C.F., hold that the solution of our difficulties can be found only by substituting for the present system a newer, broader, sounder economic system known as Socialism."

•

The official name of the Hitler party in Germany is the National Socialist Party.

A vote for the C.C.F. candidate on June 26th is a vote for Socialism.

Do not be misled by C.C.F. canvassers.

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Socialism:

- left centre
- government control of means of production
- democracy favoured
- free enterprise is inefficient and wasteful

Political Economies

Capitalism:

- moving to the right
- freely elected gov't
- private property encouraged
- free market for consumers and producers
- Adam Smith stressed the “invisible hand”



Political Economies



Fascism:

- extreme right
- free market economy
- non-democratic/authoritarian gov't
- private property ownership encouraged if gov't dictates followed

Canada's Economic Goals

- Every economic systems attempts to establish economic goals in order to use productive resources efficiently.
- Some goals are complementary – reaching one goal makes it easier to reach another
 - Example interest rates are lowered to achieve employment goals and economic growth
- Some goals are conflicting – reaching one goal makes it more difficult to achieve another.
 - Government may increase interest rates to promote price stability but this decrease employment levels which in turn decreases productivity and efficiency

1. Political Stability

- Stable governments help long-term planning and investment to flourish
- Consistency promotes investor confidence and provides a climate conducive to economic growth

2. Reduced Public Debt

- Government cannot add to public debt without adversely affecting the economy
 - Interest rates, as do prices for consumer goods
- Canadian must demand more balanced budgets from their elected governments.

3. Economic Growth

- Defined as an increase in the economy's total production of goods and services.
- Theoretically it represents an outward shift in the country's Production Possibilities.
- As economic production expands, Canadians will have more goods and services at their disposal, thereby increasing the average living standard.

4. Increased Productivity and Efficiency

- Maximizing productivity means that scarce productive resources are put to efficient or wise use in order to get as much as possible out of them.
- Economic efficiency is often the result of healthy competition.

5. Equitable Distribution of Income

- Most value-laden and controversial goal.
- Many interpretations of what makes a fair division of wealth.
- Regional differences further complicate income equity
 - Ex: Employment incomes higher for residents of Ontario in comparison to the Atlantic provinces.
- Federal government attempts to redistribute national wealth through transfer payments.
 - Using revenues from one province to make additional social program payments in another.

6. Price Stability

- Stable prices generally indicate a healthy economy.
- Fluctuating prices complicate planning and discourage investment.
- Inflation and deflation are symptoms on an unhealthy economy.
 - Inflation – general rise in prices
 - Erodes dollar's purchasing power
 - Deflation – general fall in prices
 - Periods of great economic crisis (Great Depression)

7. Full Employment

- In an attempt to reach optimal production targets, governments try to promote the full employment of the labour force.
- Unemployed workers result in total output levels well below the national PPC.
- Full employment is usually defined as between 6 and 7 percent of the labour force out of work.
 - Unemployment rate in Canada was at 5.7 percent in December of 2017.

8. Viable Balance of Payments and Stable Currency

- If Canadians import more than we export, there will be a negative effect on employment rates as well as the foreign exchange value of the Canadian dollar
- It is important that imports and exports are roughly balanced.

9. Economic Freedom

- Refers to the freedom of choice available to workers, consumers, and investors in the economy.
- Workers need to be free to find and take another job.
- Consumers need to be free to purchase what they want (consumer sovereignty).
- Canadian public policy generally promotes economic freedom.

10. Environmental Stewardship

- Economic activity must be carried out without significantly harming the natural environment.
- This may mean higher prices for consumers and lower profits for producers.
- It raises a moral issue: if Canada trades with a country that has low environmental standards, does this mean our government is condoning the policies of the other country?