

Module 1

Understanding the National Economy and the Operators

A Workshop Presentation

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12-16 April 2010, PanAfric Hotel, Nairobi

Overview

- ◆ What is an economy?
- ◆ What are the key operators in a national economy
- ◆ What is Gross Domestic Product(GDP)?
- ◆ What are the key Sectors in the national economy?
- ◆ What are the two broad schools of economic thought?
- ◆ Summation +Discussion

Learning Objective

- ◆ By the end of the presentation, participants should possess:
 - An enhanced understanding of the national Economy
 - An enhanced understanding of operators in an economy
 - An appreciation of major competing schools of economic thought
 - An appreciation of the concept & measurement of Gross Domestic Product(GDP)

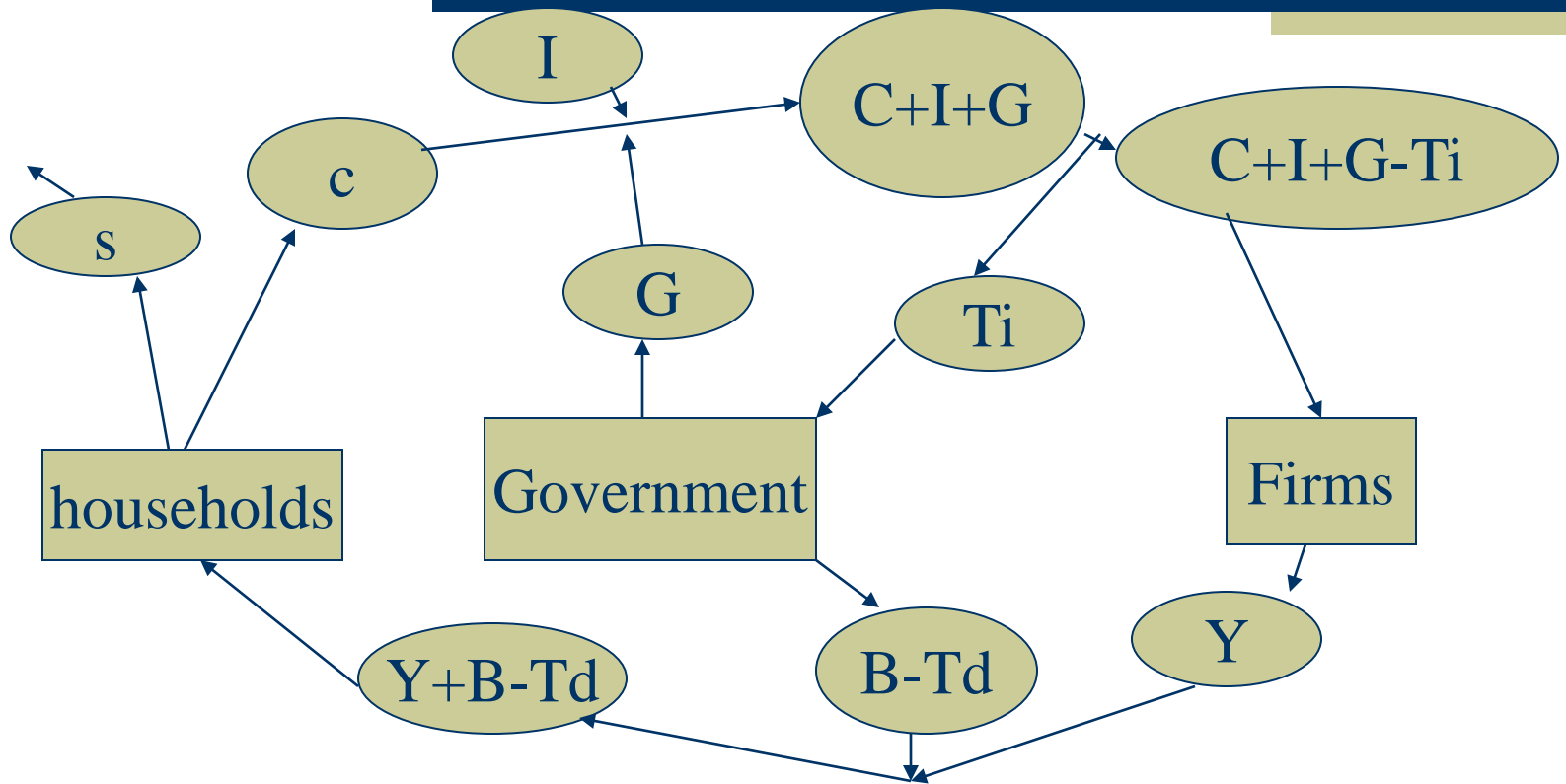
What is an Economy?

- ◆ An Economy is an integrated system of production, distribution and consumption of goods and services.
- ◆ It comprises millions of individual economic units: households, business firms and Government.
- ◆ Together, their individual decisions determine the economy's total spending, income, and output.
- ◆ Individuals are suppliers of factor inputs to firms and buyers of goods and services from firms.
- ◆ Firms are buyers of factor inputs from individuals and producers of goods and service

Transactions by households and firms

Households	Firms
Supply factor services to firms	Use factors to make output
Receive factor incomes from firms	Rent factor services from households
Buy outputs from firms	Sell output to households

The economy



The Circular flow of income

- ◆ Firms make factor payments Y to households.
- ◆ Disposable income $Y+B-T_d$ also includes transfer payments B less direct taxes T_d
- ◆ Disposable income goes on savings S or consumption C .
- ◆ This spending is augmented by injections of Government spending G on goods and services and by Investment I .
- ◆ From $C+I+G$ or GDP at market prices, we must subtract the leakage of indirect taxes T_i to get GDP at basic prices Y which firms pay out to households

What is Gross Domestic Product?

- ◆ GDP is the market value of all final goods and services produced within a country in a given year
 - Total 'market value' means that we take quantities of goods produced, multiply them by their respective prices, and add up the totals.
 - 'Final goods'. i.e finished goods ad services produced for the ultimate consumers
 - 'Produced' ...GDP measures the current production of an economy
 - 'Within a country' ...GDP includes the value of production within the boundaries of a country
 - 'In a given years' ...because GDP is expressed as rate of current production, goods produced in previous years would not be included in this years GDP.

The Components of GDP

- ◆ The GDP of an economy can be reached by totaling the expenditures on goods and services produced during the current year
- ◆ This method of calculating GDP is called the Expenditure Approach
- ◆ When derived by the expenditure approach, there are four components of GDP
 - Personal consumption expenditures(C)
 - Gross private Domestic Investment(I)
 - Government Purchases of Good and Services(G)
 - Net Exports(X-M)
- ◆ Therefore, we can write the equation for GDP:

$$\text{GDP} = C + I + G + (X - M)$$

What GDP does not measure

- ◆ GDP is not a perfect measure even though it is the best single measure. Some flaws include:
 - GDP ignores transactions that do not take place in organized markets e.g. if you grow and consume your own vegetables your labour services add nothing to GDP.
 - GDP ignores the underground and informal economies.
 - GDP does not reflect the quality of goods that make up a nations output
- ◆ In spite of these limitations, GDP is a reasonable estimate. It was never intended to measure economic well-being or happiness of a nation's residents.

What are the the key sectors in a national Economy?

- ◆ CSO identifies the following key sectors in the case of the Zambian economy:
 - Agriculture, Forestry and Fisheries[primary sector]
 - Mining and Quarrying [primary sector]
 - Manufacturing [Secondary sector]
 - Electricity, Gas and Water [Secondary sector]
 - Construction [Secondary]
 - Whole and Retail Trade[Tertiary sector]
 - Restaurants, Bars and Hotels[Tertiary sector]
 - Transport, Storage and Communications[Tertiary sector]
 - Finance and Insurance[Tertiary sector]
 - Real Estate and Business Services[Tertiary sector]
 - Community, Social and Personal Services, Including public services[Tertiary sector]

Sector Contribution to GDP in Zambia(2005)

Sector	Contribution to GDP(%)
Agriculture, Forestry and Fisheries	14.2
Mining and Quarrying	8.6
Manufacturing	10.6
Electricity, Gas and Water	2.6
Construction	9.1
Wholesale and retail trade	18.3
Restaurants, bars and hotels	2.5
Transport, Storage and Communications	6.5
Finance and insurance	7.5
Real Estate and business	9.1
Community, social and personal(incl public services	7.5
others	3.5

Real GDP Versus Nominal GDP

- ◆ So far we have expressed GDP in terms of prices existing in the year in which the goods and services are produced.
- ◆ Such an expression gives what is known as nominal GDP, or current-price GDP
- ◆ To make comparisons over time when prices are changing, nominal GDP is adjusted so it reflects only changes in output and not changes in prices
- ◆ Thus, Real GDP, or constant-price GDP, is nominal GDP adjusted to eliminate changes in prices.
- ◆ Real GDP is thus superior to nominal GDP for assessing the performance of the economy, especially rates of economic groups
- ◆ The price index used to convert nominal GDP to real GDP is GDP deflator

Two Broad Groupings of Modern Economic Thought

- ◆ There are two broad groupings of modern economic thought;
 - Neo-Classical = Orthodoxy [e.g IMF, World Bank WTO etc],
 - Keynesians = Alternatives [e.g. UNCTAD, UNICEF, UNDP etc]
- ◆ The major cause of the difference between these two major groupings is their interpretation of the nature, working and result of the market system.
- ◆ The fundamental conviction of the neo-classical is that private property, liberalised markets, and international economic integration guarantees;
 - Minimum cost of production and maximum welfare
 - Distribution of factor income is determined by preferences and productivity
 - High and stable growth, low unemployment, low inflation and external payment balance
- ◆ Neo-classical maintain that State should stay out of the economy, hence emphasis on privatisation/commercialisation of public services

Groupings in Modern Econ Thought contd

- ◆ The fundamental conviction of the Keynesians is that Private property, a market system and international economic integration can yield economic growth and benefits to society but;
 - Production is not necessarily at minimum cost, some sectors of society may not gain as much as others, and some some may even lose.
 - Income distribution is determined by power relations and not preferences and productivity
 - Growth is not necessarily stable and can be low for long periods, unemployment and inflation can be high for long periods and external balance can be in deficits for long periods
- ◆ State has an important role to play in the economy, hence emphasis on role of public sector in service provision

Summation

- ◆ An Economy is an integrated system of production, distribution and consumption of goods and services
- ◆ Key operators in an economy are households, firm and government
- ◆ Economists have developed a single statistic to measure the output of an economy. This statistics is known as gross domestic product.
- ◆ GDP is the market value of all final goods and services produced within a country in a given year.
- ◆ When derived by the expenditure approach, there are four components of GDP: personal consumption expenditures, gross private domestic investment, government purchases; and net exports to foreigners
- ◆ GDP is not without flaws but it is the best single measure of the value of output produced by an economy.
- ◆ Real GDP is superior to nominal GDP when assessing rates of economic growth.

Practical Exercise

- ◆ Should rewards to factors of production, including labour be based on productivity or on power relations. Justify.
- ◆ What actions and strategies should trade unions advance to ensure improved economic governance in Africa:
 - Within this context, what issues require research investigation to consolidate labour's position.
- ◆ You general secretary has asked you to provide him with a brief analysis of the current state of the national economy for an upcoming meeting with the IMF and the world bank. What are the key socio-economic indicators that you will need to include. Please also provide a justification for their inclusion and what relationship and/or correlations will you highlight to effectively underscore labour's view.