

**Macroeconomics;** Looks at aspects of the overall economy.

Example; the value of a country's production of goods and services (GDP) or unemployment rate of the economy.

**Microeconomics:**

Examples: Wages in the auto industry. How companies decide what quantity to produce.

“Economic way of thinking”

Microeconomics 1st canadian edition by karlan et al

Midterm exam: 35%

Final: 45%

Connect: 20%

Midterm; November 2 and October 31

One hour for each part

Multiple choice questions

Short answer questions

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## Origins of economics

-Economika: Mentioned in Aristotle's book “Politics”

-Economics referred mainly to **household management** (using a limited budget to best provide for all the needs of a household)

-The **Industrial Revolution** was a period in which England (and eventually Europe and America) evolved from an agricultural-based society into a machine-driven industrial economy. Happened in late 18th and early 19th centuries.

-Industrial Revolution was ushered in by the practical application of the steam engine (patented in 1769 by James Watt) and other machines (“capital equipment”) thus replacing slow production of manual labour.

-Ex: Steam engines provided power for the first railways, which were used to move coal out of English mines in much higher volumes. Steam engines also powered mechanical looms, increasing textile output.

Even though the ancient Greeks had developed a steam engine in the first century AD - Heron of Alexandria “Aeolipile” - the first practical application of a steam engine ...

-The Industrial Revolution gave rise to a new class of people: middle class//business people a.k.a “Bourgeoisie.” They were the capitalists who owned most of the means of production, which consisted of mainly of new machines and factories. To make a profit for themselves, they expanded their operations and thus became wealthier. “Entrepreneurs”

-Output of English economy increased spectacularly.

-Not everyone was rich. Majority of English worked lives in squalor, trading the subsistence life of farming for city life in “England’s dark satanic mills” - William Blake

-Business class was becoming prosperous, new patterns could be observed

-Strong **competition** emerged as the new capitalists searched for profits. → Supply and Demand.

-Adam Smith: 1723-1790. (Division of labour and supply and demand) Father of Economics. First to analyse the behaviour of new business class in his landmark book, “The Wealth of Nations” published on 1776 (same year as the American Revolution)

-His theory: Efficiency. Putting resources to highly-valued use. **Division of labour**: Example: 18 labourers working separately could only make a few hat pins each hour. But if each of the workers specialize in one step of the process - like an assembly line - together they could make thousands.

-**Invisible hand**: Led individuals, interested only in their own gain, to increase prosperity of the nation.

-The result of the free competition created wealth, efficiency and a spectacularly greater amount of output in the nation, Smith also pointed out that whenever possible producers would try to

band together to raise prices artificially, for greater profit - in other words, to attempt a conspiracy against the public: **MONOPOLY**

- David Ricardo followed by John Stuart Mill (comparative advantage) go a long way in explaining the workings of a modern economy like Canada's - the first classical economists.
  - The modern theory of supply and demand was developed by Alfred Marshall.
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### **What is economics:**

- Scarcity
- Unlimited wants
- Decision making
- Opportunity cost

### Origins of economics:

- From Greek meaning "household management"

### The "Economic problem"

- What will be produced
- How much
- How
- Who gets it

### What is the economy?

- A network
- A system
- A region
- Solves the economic problem

### Types of markets:

- Command → Organized government
- Mixed → We live in.
- Market

### The legitimate role of government in the economy:

- Rule of law:** (property rights; contract enforcement, judiciary)

- Solid currency and monetary system
- Health and safety legislation

In microeconomics:

- Addressing "market failure" (monopoly dead-weight loss)
- Provision of public goods
- Laissez faire or more government intervention

In macroeconomics;

- Central bank and money supply
- Taxation
- Stabilization policy

What is an economic model?

- Representation of reality
- Simplified
- Minimal assumptions
- Like a roadmap - omits unimportant details so that major roads and landmarks can be understood
- Circular flow- A model of the economy presented as a diagram
- Most economic models are expressed through a system of equations

### **Comparative advantage:**

The name of the economic theory that explains how trade makes everyone better off and why impeding trade is not a good idea.

**Opportunity cost:** Giving up something to get something

### **Gains from trade:**

-Instead of trying to make everything you need yourself, you will be better off specializing in what you're really good at doing and trade some of it for things that other people are better at making than you

### **How to know what to specialize in?**

- Compare opportunity costs with the opportunity costs of potential trading partners.
- Lowest opportunity cost = what u should specialize in

**How to calculate opportunity cost** = give/get

**Production possibilities:**

The data or facts about how much of each good or service you could produce per period or with a unit

The intercepts on ppf are amount of each good that could be produced if all the persons resources were put into the production of only good on each axis.

Specializing and trading will allow everyone to consume a better combination outside their PPF.

**Absolute advantage**

- Whoever can produce more of a product in a particular period or with a unit of productive resources has an absolute advantage in the production of that product
- We could say that they have the highest productivity

Comparative vs absolute:

- Productivity
- Opportunity cost

-You have an absolute advantage if you are the least cost producer (or the most efficient producer) in the production of every good or service

-You have comparative advantage if you have the lowest opportunity cost in the production of a particular good or service

-Lawyer and secretary example.

Comparative advantage:

Compare each persons opportunity cost in producing a particular object

-Whoever has lowest opportunity cost has a comparative advantage in the production of that product

Discover comparative advantage?

- 1. List the data
- 2. Calculate the opportunity cost on a ‘per unit’ basis

-3. Identify the lowest opportunity cost for each product

(ALWAYS one person will have lower opportunity cost for one product and other person would have lowest opportunity cost for the other product, unless the other person has exactly the same production possibilities)

## **2 ways to get a product**

-Produce it yourself or produce something else that you trade away to get it

An exchange rate that is between the opportunity costs of the potential trade partners allows each person to obtain the the other

### **The exchange rate for trade:**

-There are two ways to get a product

1. Produce it yourself
2. Produce something else that you trade away

An exchange rate that is between the opportunity costs of the potential trade partners allows each person to obtain the other product more cheaply than if they made everything themselves.

### **Slope of ppf is opportunity cost**

-Rise/Run or  $y/x$

-The slope shows the rate at which you would have to give up x to get y - which is the opportunity cost of getting y.

### **Opportunity cost is constant for individuals**

Unlike the concave PPF of a country the PPF of a person is a straight line with a constant slope (which represents constant opportunity cost)

This is b/c one person will have the same ability to produce more unit of a product regardless if they are producing just a little or a lot of it.

(When a country wants to produce more of something it must transfer resources that are less and less productive in the alternative field, so the opportunity cost rises and gives a country's PPF a curved, constant shape)

Example: North Korea

### **How do they settle on an exact exchange rate for trade?**

1. By negotiating
2. If one is an economic or political they will try to take most of the gains for themselves leaving the trading partner with a very small gain, but still enough to give an incentive to trade (otherwise the bully would not be able to gain anything)
3. Or if they were already overwhelmed by all the material in this chapter, they might just split it down the middle
4. The best answer is probably markets will determine the exchange rates for trade, just as they determine most prices of goods and services within the economy.

### **Does getting more of both goods always make us better off?**

No. Not quantity, but is better off for combinations. Quality vs quantity.

If you were a poor student surviving by eating cat food and a bit of high quality beef, to be better off, you would like to eat more and less cat food.

Just because a point is beyond your PPF it does not necessarily mean that you would be better off consuming the combination of products represented by that point.

### **Decreasing Marginal Utility;**

The law of diminishing marginal utility.

The Law Of Diminishing Marginal Utility states that all else equal as consumption increases the marginal utility derived from each additional unit declines. Marginal utility is derived as the change in **utility** as an additional unit is consumed. Utility is an economic term used to represent satisfaction or happiness. Marginal utility is the incremental increase in utility that results from consumption of one additional unit

Utility is the capacity of a commodity through which human wants are satisfied.

Assume that a consumer consumes 6 apples one after another. The first apple gives him 20 utils (units for measuring utility). When he consumes the second and third apple, the marginal utility of each additional apple will be lesser. This is because with an increase in the consumption of apples, his desire to consume more apples falls.

Therefore, this example proves the point that every successive unit of a commodity used gives the utility with the diminishing rate.

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### **Supply:**

As Quantity increases, we become less and less efficient due to fixed constraints (such as size of work room) Therefore marginal costs go up as we produce more and more. We will only produce more if the price is higher to cover the higher cost.

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Dead weight loss

When less than the equilibrium amount is produced total, is not maximized

The surplus that we miss out on is called dead-weight loss

This not surplus, that is expropriated, from one group and enjoyed by another. Rather this is surplus that nobody can enjoy. Again, you cannot get a surplus from units that are not produced.

### **Government interventions can cause deadweight loss.**

-Rent control laws (and price ceilings in general) cause deadweight losses.

-Minimum wage laws (and price floors in general) cause deadweight losses.

-There are not good policies from the standpoint of economic efficiency and is the reason economists are against them

## **Income distribution and equity.**

While maximizing total surplus is good for society overall, this says nothing about how the benefit of that surplus is distributed among people within the economy.

-Maximizing total surplus is like getting the economic pie to be as big as possible. But the free market does not reward everyone with an equal slice of that pie.

-Government policies may be introduced to equity

## **Free markets.**

-Economists favour the equilibrium point that a free market produces not out of some hands-off (laissez faire) ideological fixation but rather because free markets maximize total surplus for society overall.

Competition has to be strong and all of the costs and benefits of economic activity must be accurately reflected by the supply and demand curves.

Sometimes these conditions don't work. This known as **market failure**.

## **Market failure**

If a single producer has a lot of power in the market, they might be able to restrict output in order to cause an artificial scarcity. This will allow them to increase prices for the sake of realizing the highest profit possible for themselves. But this produces a deadweight loss and is not good for society.

If a producer is not forced to cover the costs that fall on innocent bystanders due to pollution or other negative externalities the market will not produce the optimum amount of that product.

IN these cases there is a legitimate role for government intervention in the economy