

**ECO1104B**  
**microeconomics**  
**David Gray**  
Introduction

**First things first!**



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1:27 PM

and while we are on the topic.....



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**Do you now feel desperate?**  
**Maybe this will help**

- <http://www.cbc.ca/news/business/flip-d-app-students-smartphones-1.4270821>



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**Agenda for today**

- Introduction of the professor
- Course information
- Presentation of on-line accessory
- Commence presentation of course material

• **This course is high tech and rigorous**

- <http://uottawa.ca>, virtual campus
  - old exams
  - Announcements
  - all of my digitalised lecture notes
  - weekly commentary from me
  - Relevant news articles
  - Course calendar

– **The Connect accessory**

- So why do we have to pay extra for this accessory, and why do we have to do the extra work?
- Because one of its functions is as the study guide
- It is designed to keep you engaged in the course every week, as opposed to studying only two times per term
- Non-exam, graded work raises the final grades of most students

**Popular studying technique**

**Two hours before mid-term examination +**

**Three hours before final examination =  
FAILURE**



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- **OFFICE HOURS MON and WED  
10:30-12:00**
- **Office Faculty of Social Sciences  
Building, 9<sup>th</sup> floor, office # 9045**

**Great economic news!**

- **The earnings premium for those with bachelors degrees compared to those with only HS diplomas is approximately:**
  - + 40 % for men
  - + 50 % for women
  - Adds up to an extra \$1,300,000 throughout your lifetime.
- **It rose drastically between 1980 and 2000 and is still rising**

- **In 2009, those workers with 4-year university degrees had an unemployment rate of 5.2 %, while those with only HS diplomas had a rate of 9.1 %**
- **This is an illustration of economic research**

**Plunge into course material**

- **the summer is now officially over**
- **yes, what I say from now on will be on the test**

## Introduction to microeconomics

- We commence with a behavioural assumption – what makes humans tick?
  - Human wants are unlimited because people are GREEDY.
    - Affects all us to different degrees
    - As well as the environment in which we live and interact
    - And so the avarice is quite systemic
    - <https://www.youtube.com/watch?v=6p-IDYPR2P8>

– Human wants are **PARTIALLY** satisfied by producing and then consuming goods and services.

- We analyze the nature of :
  - production activities - theory of the FIRM
  - consumption activities - theory of the CONSUMER
  - exchange activities - coordination between them - theory of MARKETS

- There are two primary types of **ECONOMIC ACTORS (ACTRESSES)**.....
  - consumers
  - producers
- ...who interact (exchange) within markets of a capitalist ECONOMY.
- An ECONOMY is an *institution* in which these actors produce, consume, and exchange.
  - Several different types

- Any economy produces goods and services by combining RESOURCES...
    - LAND
    - LABOUR
    - CAPITAL
  - ...into a TECHNOLOGY OF PRODUCTION
- 
- factors of production

- **Economic Resources**
  - Land: natural resources or any derivative thereof
    - crops, minerals, land itself (on which buildings and structures LIE, not “lay”)
  - Labour: human effort
  - Capital: something that is used to make something else
    - structures, vehicles, plant & equipment, machinery
    - It is not altered or consumed in the production process, but it does depreciate.

- These resources available only in limited quantities, and therein lies the rub. figure of speech
  - unlimited wants
  - limited means to produce them

first domino:

**● SCARCITY**

– <https://www.youtube.com/watch?v=g5W4k6vD2WY>

second domino:

- **SCARCITY** is this fundamental conflict.
  - Every economy from the centrally planned, socialist economy to the purely capitalist, faces it.
- Because of scarcity, consumers and producers have to make **CHOICES**
  - Learning Objective 1.1
    - Page 4

third domino:

- All choices involve incurring an **OPPORTUNITY** cost.
  - defined as the value of the option that was NOT selected: the highest foregone alternative
  - no scarcity, no choices
  - no choices, no opportunity cost
  - Learning Objective 1.2
    - It does not necessarily have a \$ value
    - Page 4 in textbook

- Illustration of a choice and an opportunity cost - my career
  - I faced the following choice in 1999-2000
    - stay at my present position and earn a fairly high salary
      - good working conditions
    - join the 'brain drain' to the USA, and earn about 50% more than my present salary
      - do research for the government or a consulting firm
  - I (obviously) chose to remain here, so the opportunity cost of that choice is the value of option # 2

- Net loss of about 50% of my current salary
- I earn positive income from an accountant's perspective, and I remained solvent.
- From the economist's perspective, I lose money **RELATIVE TO WHAT I COULD EARN ELSEWHERE.**
- Am I irrational? I lose out on **PECUNIARY** terms, but non-pecuniary terms entered my decision.
- Now I am too old to face such an attractive choice

- if no opportunity cost, then it's a **FREE** good, but.....
- There is **NO** such thing as a free good
  - **everything** has a cost in terms of resources foregone.
  - despite the denials of politicians, who promise higher living standards without giving up anything in return

- Dalton McGuinty said in 2003 that his government would boost spending on education and health care, not incur a budget deficit, and not raise taxes
- Quebec students in 2013 demanded “accessible” (read free) university educations for themselves, which is to be financed by “taxing the rich”

- Donald Trump in 2016 promised to abolish ‘Obama Care’, lower health insurance premiums, and guarantee universal health care
  - More health care provided at a lower cost



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- **Two corollaries of learning objective 1.2**
  - Examine value of the preferred option or choice **COMPARED TO THE ALTERNATIVES**, not just its \$ value
  - Just because a certain option or choice confers benefits does not necessarily mean that scarce resources should be allocated to it
    - Example: Ottawa’s light-rail transit system
      - Currently under construction
      - “On-track 2018”? We can only hope!

- Example: There is a proposal to invest in high-speed passenger train service between Quebec City and Toronto (Globe and Mail, 25/8/2017)
  - <https://beta.theglobeandmail.com/news/what-to-do-with-via-rail-ottawa-weighs-multibillion-dollar-boost-to-passengerrail/article36082017/>
  - bad economic reasoning: “It will create hundreds of short-term jobs. What do you have to lose?”
    - All of the local mayors are boosters
    - As are the construction workers’ unions

- **NO / NON**
- **WRONG / FAUX**
- **FALLACIOUS**
- **FALSE**
- **NONSENSE**
- **ERRONEOUS**

- This is the ‘manna from heaven’ or ‘free lunch’ fallacy.
- The construction of the olympic venues incurs an **opportunity cost**
  - land, labor, capital must be reallocated from other potential uses, which might (or might not) be more productive elsewhere

## THE MARKET ECONOMY

- There are many types of economies
  - Robinson Crusoe
  - Tribal
  - Feudalistic = self-contained economy
  - Command
  - free-market
  - social democratic (mixed) Canadian economy
- We will study the workings of the MARKET economy
  - albeit one with a large public sector

## • Any economy has to address THREE COORDINATION TASKS

- WHAT goods and services should be produced, and in what quantities?
- HOW should they be produced? In other words, what is the technology?
- FOR WHOM are the goods and services produced?

- How does the market economy go about addressing these tasks? Resources = land, labour and capital allocated to their HIGHEST AND BEST USE.resources

- WHAT goods and services will be produced?
  - Those that are PROFITABLE. Production of unprofitable G&S is discontinued.
- HOW to produce them?
  - The LEAST COSTLY TECHNIQUE of production

## – For WHOM? (not ‘for who’)

- G & S are distributed according to the ability to pay. Those with high (low) incomes have a large (small) claim on the production.

- The key feature of a market economy is the DECENTRALISED fashion in which consumption, production, and exchange decisions are made.

- The primary ALLOCATIVE mechanism used is the PRICE SYSTEM

- Another key feature is that it is extremely INEGALITARIAN

- The textbook mentions ‘inequity’
- It generates winners and losers, and is quite cruel to the losers
- Distribution of rewards/penalties very unequal, and becoming more so over time
- Left-wing people view it as very unjust and rapacious

- **EFFICIENT** in that shortages and surpluses are eliminated, and production of goods and services is in line with society's needs and wants and is maximized in the face of scarcity
  - LO 1.4
  - The 'left' says that it typically produces the wrong things

- **DYNAMIC** as it adjusts rapidly to changes in technology, consumer tastes, demography
  - e.g. if consumer tastes change, money can be made (lost) in producing the product in favor (out of favor). Producers and consumers react quickly to **PRICE CHANGES**
    - Family restaurant chains
  - Related to learning objective 1.3, as incentives play an important role

## COMMAND ECONOMY

- The **COMMAND** economy is the antithesis of the market economy.
  - discussed here for illustrative purposes
  - Canada's health care systems operate like this to some extent
  - A bit like the child's game 'Simon says'
- It executes the three essential tasks in a **CENTRALIZED** fashion. All allocative decisions made at headquarters.

- **WHAT?**
  - The central planning bureau sets **OUTPUT** quotas for production units.
- **HOW?**
  - The central planning bureau allocates the inputs and specifies the technique
- **FOR WHOM?**
  - The central planning bureau allocates the goods and services to workers via rationing

- Other key features include:
  - It is **EGALITARIAN** as it rewards all agents relatively equally
    - quote of Marx
    - quote of Orwell from "Animal Farm"
  - It is **INEFFICIENT** in that shortages and surpluses are common, and **STATIC** as it does not adjust rapidly to changes in technology, consumer tastes, demography.
    - Producers cannot react quickly. All orders to produce more of this and less of that have to go through a very long chain of command.

## SUMMARY OF INTRO

- **MICROECONOMICS IS ALL ABOUT....**

## ● P's and Q's

- why are prices what they are?
- why are quantities what they are?

- Use ECONOMIC MODELS as our primary analytical tool for economic events and behaviour.

- NOT designed to imitate reality with exactness, but rather to describe the workings of the economy and to make predictions.
- By necessity, models involve gross simplifications, and are based on assumptions which are often unrealistic.

- consist of premises, rather than unqualified predictions.

- Example: I am asked so often: What is going to happen to interest rates or exchange rates?

- I respond: That depends on .....IF rates in the USA go up, THEN rates in Canada will go up.

- Primary model for the course is the Supply and Demand Model

## Illustration of what economists do

- Forecasting is a small part of it
- Apply microeconomic analysis to the obesity epidemic
  - In USA obesity rates have doubled since 1990
  - One contributing factor is economic (there are other forces at work)
    - After adjusting for inflation, price of fruits and vegetables up 75 %
    - After adjusting for inflation, price of fats down 27 %
    - Thus consumers have an economic incentive to say 'super-size me' and eat accordingly