

What is Economics?

EC 201: Principles of Microeconomics

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Prologue

Who am I?

Kyle Raze

- Doctoral student in economics
- UO alumnus: BA '15, MS '17, & PhD '21
- Applied microeconomist and econometrician
- I study the economics of education and labor (and sometimes politics).

Where can you find me?

- Office: 522 PLC
- Office hours: Monday 14:00-15:00, Tuesday 15:00-16:00, or by appointment
- Email: raze@uoregon.edu **(use EC 201 in the subject line)**

What is economics?

What is economics?

According to John Maynard Keynes,

The theory of economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique of thinking which helps its possessor to draw correct conclusions.

Why study economics?

Develop critical thinking **skills that employers value**.

Cultivate **healthy skepticism**.

Learn to navigate a diverse set of **policy-relevant** questions.

Why study economics?

Navigate important questions

- Should college be free?
- Would universal healthcare make us healthier?
- Who benefits from a \$15 minimum wage? Who suffers?
- Why is the rent so damn high?
- What can governments do to address climate change?
- Why are governments taking so long to address climate change?

Why study economics?

Navigate important questions

- Does immigration reduce wages for native workers?
- Do cigarette taxes make smokers happier?
- How much should the university charge out-of-state students?
- Should cities pay for professional sports stadiums?
- How does grade inflation affect labor market outcomes?
- Why is there grade inflation?

Q: Do additional freeway lanes **reduce congestion**?

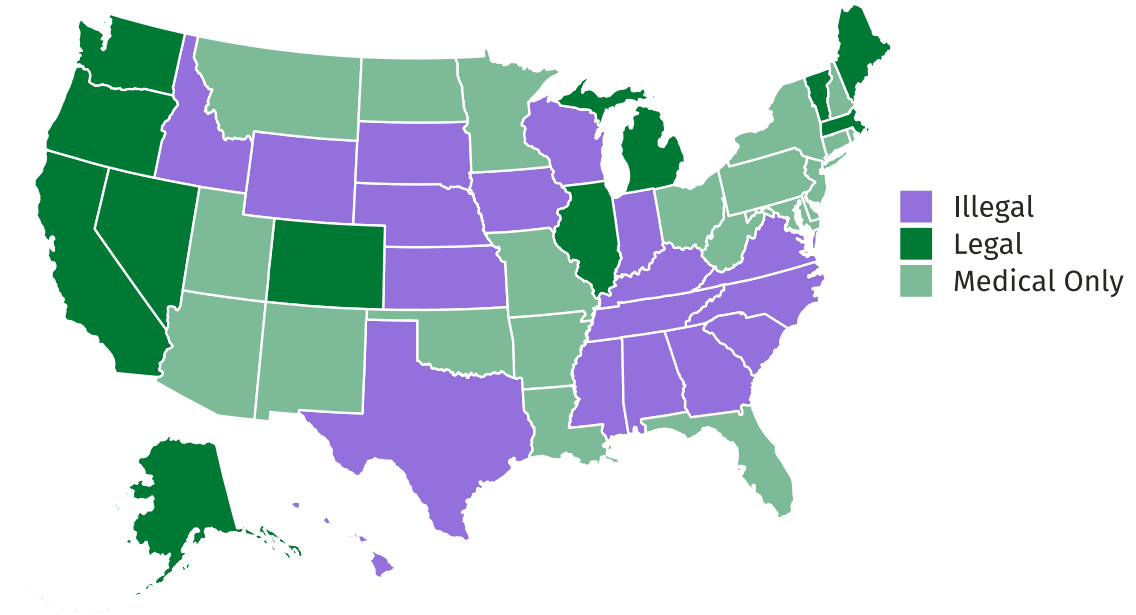


How do additional lanes **change the price** of driving **relative** to alternative **modes** of transportation?



Q: Should the federal government legalize cannabis?

State Cannabis Laws (2019)



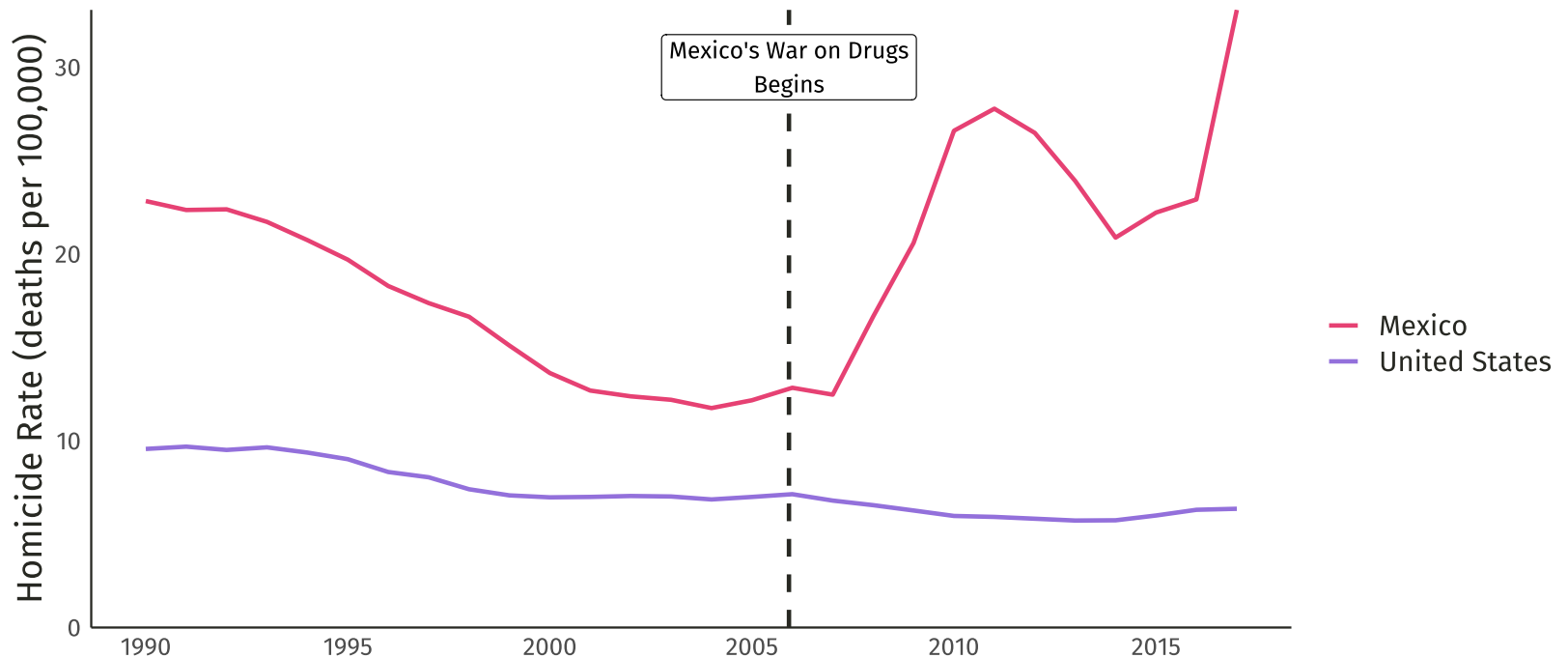
Source: National Conference of State Legislatures

What about meth?

The bigger question: What are the relevant trade-offs of legalization?

Q: Does a "kingpin" strategy weaken drug cartels?

- Principal strategy in Mexico's War on Drugs
- New cartels \Rightarrow more competition \Rightarrow more violence



Source: Our World in Data

Q: Should the government require insurance companies to pay for a second night in the hospital following childbirth?

- Overnight hospital stays are expensive.
 - How expensive? Expensive enough that parents rarely opt to pay for a second night.
- If insurance companies are required to cover two nights, then **premiums will increase**.

The real question: Are you willing to make some parents more comfortable if it means that **others will lose coverage** for basic care?

Q: Suppose you learn that orchestras employ many more male musicians than female musicians? **How would you explain this?**



Do orchestras **discriminate** against women?

Natural experiment: In the 1950s, American orchestras introduced "blind" auditions.

- **Result:** Women 50% more likely to make past the first round and several times more likely to make the final cut.
- **Takeaway:** The evidence is *consistent* with discrimination.

Q: The university has a fixed number of student tickets for each home football game. Which of the following ways of dispensing tickets is discriminatory?

- A.** First come, first served.
- B.** Distribute them using a random drawing.
- C.** Raise the price until that number of students want tickets.
- D.** Distribute them according to GPA.
- E.** All of the above.

Note: Starting next class, we'll use iClickers for questions like this one.

What is economics?

Textbook definitions

The study of how humans coordinate their wants.

The study of how scarce resources, each having alternative uses, are allocated amongst competing ends.

The study of how individuals and societies allocate their limited resources to satisfy their unlimited wants.

Common thread: **scarcity**

- A not-so-dismal **objective**: learn how we can better **mitigate the costs of scarcity**.

What is economics?

Micro vs. Macro

Microeconomics focuses on the causes and consequences of the choices people make in a market economy.

- What factors constrain the choices of individuals? How do people respond when we relax those constraints or impose new ones? Do we like the consequences?

Macroeconomics focuses on the performance of entire economies.

- How do we grow the economy and avoid recessions?

Is economics a science?

Economics seeks to explain real-world events by way of observation → hypothesis → prediction → experimentation → conclusion.

Economists employ the scientific method to learn about human behavior.

- Difficult to conduct controlled experiments like those in chemistry or physics.
- **Alternative:** approximate controlled experiments with randomized control trials, psychology-style lab experiments, and natural experiments.

Is economics a science?

Focus on *human* behavior \Rightarrow social science.

The core fields of social science are anthropology, economics, political science, psychology, and sociology.

- Common objective: explain some aspect of human behavior.
- They differ in the questions they pose and their frameworks for analysis.

Example: *Blue Paradox*

Recent study by UO economist Grant McDermott and coauthors.

Question: Do commercial fishers preempt fishing bans by increasing their fishing effort before the bans go into effect?

Motivation

- Recent conservation efforts seek to preserve aquatic habitat and increase fish stocks.
- Policy lever: Restrict fishing activity in marine protected areas.
- Concern: Preemptive behavior could *decrease* fish stocks.

Approach

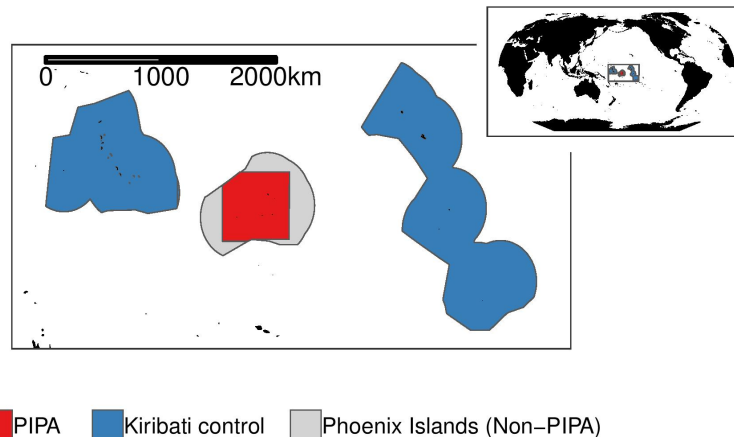
- Use vessel-level data on fishing effort/intensity to measure the behavioral response to impending fishing restrictions.

Example: *Blue Paradox*

Natural Experiment

Phoenix Islands Protected Area (PIPA)

- First mentioned on 1 September 2014; implemented 1 January 2015.
- *Treatment group*: PIPA.
- *Control group*: Outlying Kiribati islands.



Example: *Blue Paradox*

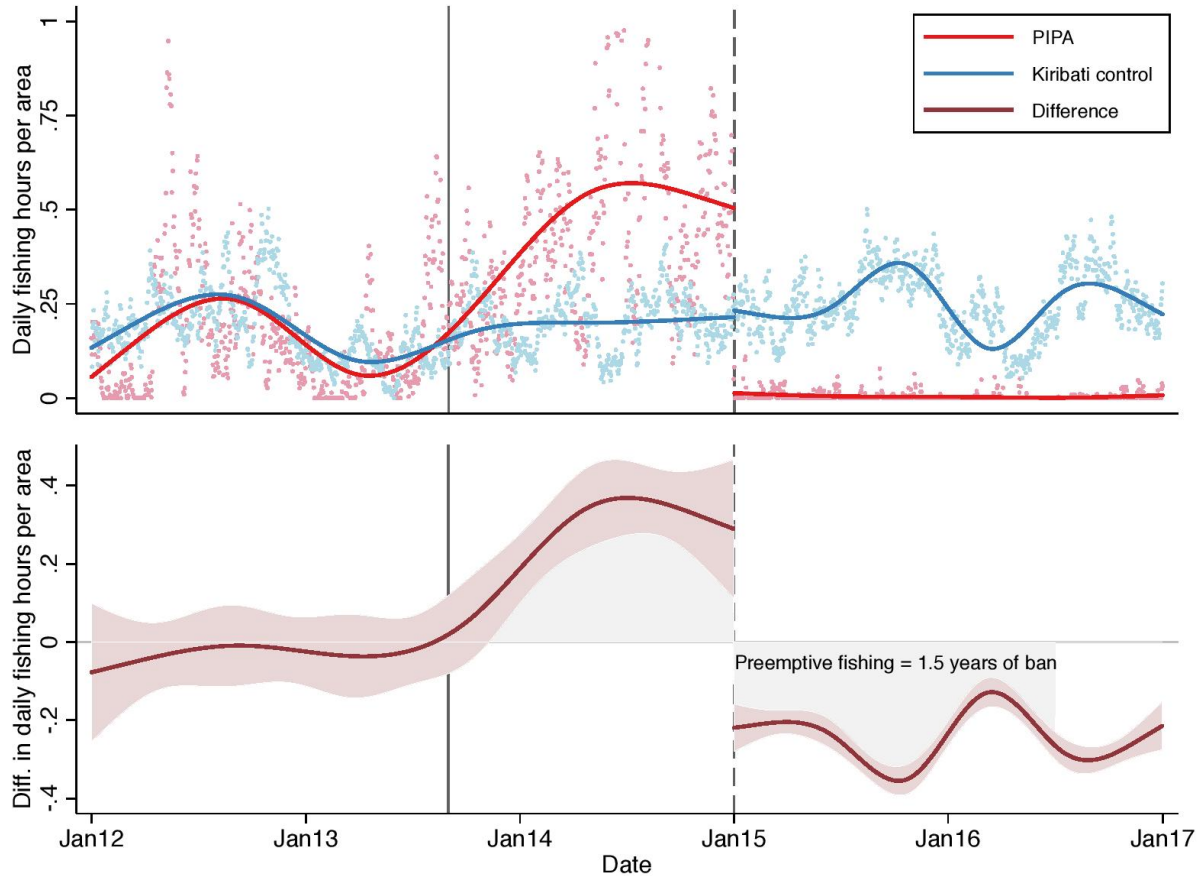
Natural Experiment

Measure the causal effect of the fishing ban by comparing fishing effort in treatment and control regions, before-and-after PIPA.

- A *difference-in-differences* comparison.
- **Assumption:** If Kiribati hadn't adopted the policy, then treatment region would have experienced the same trend in fishing activity as the control region.
- If we believe this assumption, then the observed difference-in-differences supports a causal interpretation. If not, then the change could reflect other factors and thus fail to isolate the causal effect of the ban.

Example: *Blue Paradox*

Results



Example: *Blue Paradox*

Discussion

Results provide causal evidence that commercial fishers engage in preemptive behavior in response to conservation policy changes.

Results are *consistent* with economic theory, but *cannot prove* that the theory is correct.

- **Science cannot prove anything.**
- Science can **falsify or reject** existing hypotheses or **corroborate** existing evidence.

Also...the causal statement rests on a critical assumption.

- Cannot prove that the assumption is true, but can falsify it.
- Failure to falsify \neq assumption is true.

What role should economists play?

It will be important for us to separate our beliefs about *what is desirable* from what we believe to be *true or false*.

Robust economic analysis consists of **positive** statements.

- *Positive statement* = statement that can be classified as either true or false.

Economists try to avoid **normative** statements in their analyses.

- *Normative statement* = statement expressing a value judgement or *what ought to be*.
- No matter how widely shared, value judgements are not scientifically justifiable (*i.e.*, they are untestable).

What role should economists play?

Q: Is there a role for the normative?

- **A:** To the extent that it is supported by well-defined positive statements, yes.
- *e.g.*, evidence-based policy recommendations.

Positive or normative?

"The unemployment rate is 3.7 percent."

- **A:** Positive statement.

"Congress should abolish ICE."

- **A:** Normative statement.

"The expiration of the US Federal Assault Weapons Ban in 2004 increased gun violence in neighboring Mexican states."

- **A:** Positive statement.

Positive or normative?

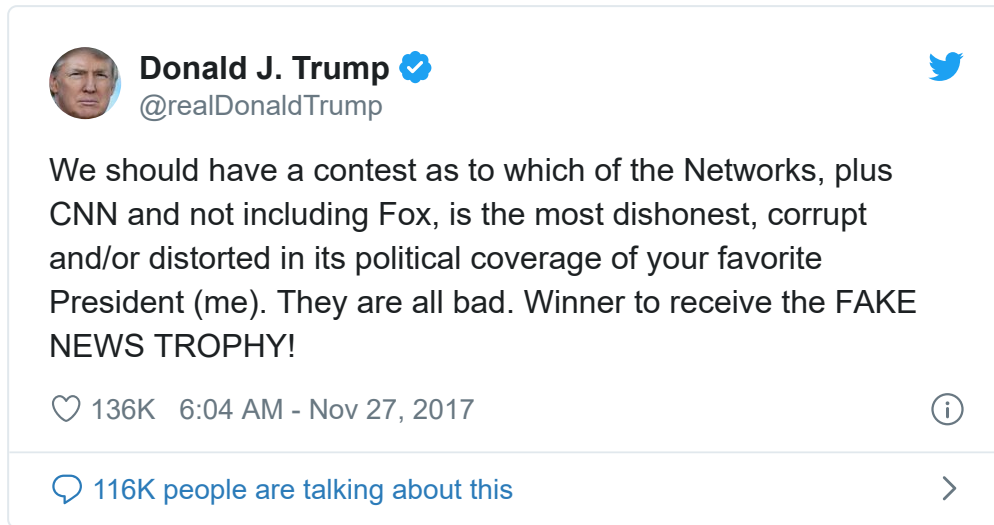
"Vaccines cause autism."

- **A:** Positive statement...that happens to be false.

"When coupled with counseling, housing vouchers provide a cost-effective means to move low-income families to high-opportunity neighborhoods. Policymakers should consider incorporating additional counseling services into federal housing assistance programs."

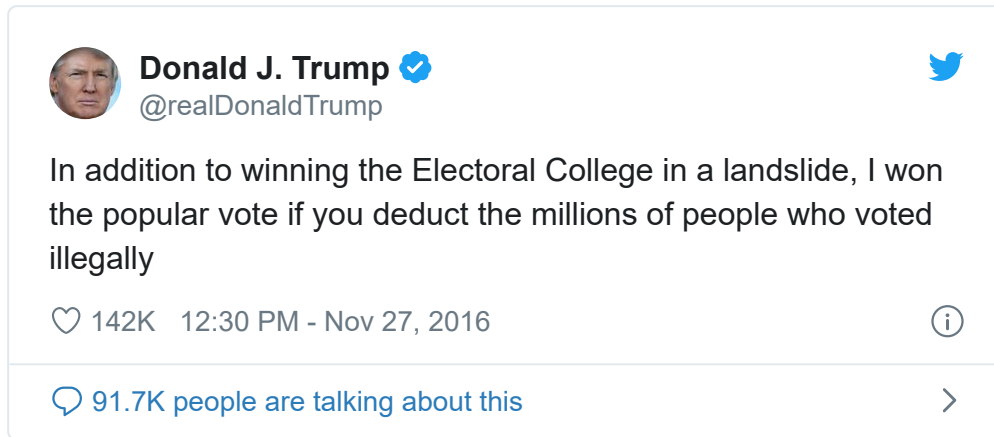
- **A:** Normative statement supported by a positive statement.

Positive or normative?



A: Normative statement.

Positive or normative?



A: Positive statement, but **unfounded**.

Prices

Q: Who coordinates the needs and wants of the 325 million people in the US economy?

- No individual commands more than a tiny part of the production of any good.
- Each individual, acting in self-interest on narrowly-defined projects, creates useful goods for consumers in exchange for wages or other remuneration.
- These activities are based on mutual benefits, coordinated by market-determined **prices**.

Economic Learning

Five important dimensions

1. Economic reasoning
2. Economic terminology
3. Economic insights
4. Economic institutions
5. Economic policy

Economic Learning

1. Economic reasoning

Framework for formulating and answering questions

How does one think as an economist?

- Define the relevant benefits and costs.
- Define the margins of importance.
- Construct a predictive model that explains past behavior and predicts future behavior.

Economic Learning

2. Economic terminology

Terminology abounds

- *e.g.*, marginal benefit, marginal cost, market power, externalities, adverse selection, price controls, utility, profit, *etc.*

Q: Why bother?

A: Discipline-specific terminology facilitates quick and precise communication of complex ideas.

Economic Learning

3. Economic insights

We base insights on economic theory.

- Theory provides generalizations about the inner workings of an abstract economy.
- *e.g.*, who coordinates the needs and wants of the millions of people in the US economy?

Economic Learning

4. Economic institutions

An institution is a physical or mental structure that influences economic decisions.

- *e.g.*, markets, private property, slavery, religion, *etc.*
- Differences in institutions can explain differences in living standards, inequality, and the way people coordinate their wants.

Economic Learning

5. Economic policy

An intervention by a government, manager, or professor that seeks to manipulate incentives associated with a particular behavior.

- To increase educational attainment among poor children, Mexico pays low-income mothers based on their children's school attendance.
- To deter shirking, Amazon ranks its employees and fires those toward the bottom of the rankings.
- To reduce the expected benefits of cheating, I generate a randomized seating chart for exams.

Incentives

People respond to incentives, but not always in the way policymakers want.

Example: License plate rationing in Mexico City



Incentives

The big question: Given that humans are self-interested, how does one conduct policy to promote social welfare?

- When are incentives aligned with what is socially desirable?
- When are they misaligned?

Our Priorities

Develop a base of knowledge from which you can build sound arguments for or against economic policies and observations.

- Build a foundation for further study in economics.
- Furnish new critical thinking skills.
- Calibrate your skepticism.