

## **In Defence of Economics 101**

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Economics professors are often accused of filling our students' heads with over-simplified assumptions, obsessing with the mathematics of theoretical models, and failing to teach them about economic phenomena in the real world.

Like any discipline trying to explain a complex world, economics faces plenty of challenges. Our models and theories are designed to organize our thinking, focus our attention on the key aspects of the issue, and provide order and reason to the complexity we seek to explain. For most of us, this process starts with Economics 101.

Perhaps the best part of teaching introductory economics is witnessing the light suddenly going on for students when they detect the logic and order that emerges from a bunch of facts they previously thought were unrelated. There are countless examples from a typical course.

Consider why a bumper wheat crop in Russia ends up harming Canadian wheat farmers, but helping Canadian ranchers. Or why the massive U.S. production of shale gas has led to a reduced burning of coal in many electricity plants. Or why rapid economic growth in China and India has led to significant expansions in Canada's resource-producing sectors. Or why an increase in the world price of oil tends to cause Canadians to move from Ontario to Alberta.

All of these events can be easily understood and explained with the economists' workhorse theory of demand and supply. This theory does not accurately describe all markets at all times, but it does a great job in many important cases. A key part of Economics 101 is learning when it works well and when it doesn't.

For a prime example of where the simple model of demand and supply needs to be replaced with something more complex, consider the markets for smart phones or mutual funds or corporate jets or high-end running shoes. In these markets, the price is not determined by the impersonal interaction of large numbers of relatively small consumers and producers, as is the case in the markets for wheat or natural gas.

Instead, a key factor is the complex "games" typically played between the various firms, games that determine selling prices as well as product characteristics. Apple works very hard to distinguish its phones and tablets from those produced by Samsung, and can charge different prices as a result. The same is true for TD mutual funds, Bombardier jets, and Nike shoes – and countless other products for which branding and product differentiation play a central role.

Once we start thinking about firms with differentiated products and the ability to set their own price, we can start to understand why firms often set different prices for different customers, even though the product may be identical. Why do seniors get a discount for movie tickets? Why do women pay far more for haircuts than men, even if hair length is the same? Why do almost identical versions of cameras sell at such different prices in a discount retailer and a speciality store? Why do identical cars cost so much more in Toronto than in Buffalo?

These examples of “price discrimination” are just a few of the hundreds that you may encounter in your daily life. But until you understand the order and logic behind firms’ pricing strategies, they’re all just a blur of disconnected facts.

Perhaps the hardest thing for students to really grasp is the notion of the gains from international trade. They see it as obvious that since some people are better doctors while others are better engineers, it is sensible for people to specialize and then trade with each other. But they err when thinking that some different and deeper principle must be at work when we discuss trade between nations. There isn’t one.

The real complexity to the international discussion comes when explaining how the freeing up of international trade, perhaps through the reduction of tariffs, leads to benefits for the country as a whole even while creating temporary costs to the labour and capital displaced in the process. That’s where the rubber really hits the road when discussing the real-world case for freer trade.

Most of us benefit hugely from having a more structured and organized way of thinking about our complex world. And that’s the real value of studying economics. If you are unsure of the answers to the many questions posed in this column, perhaps Economics 101 should be part of your future.

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