



## Chapter 1

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### Preliminaries



### Introduction

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- What is math? History? Music?
- What is ECONOMICS?
- What is MICROECONOMICS?



### Themes of Microeconomics

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- Microeconomics deals with ( )
  - Limited budgets
  - Limited time
  - Limited ability to produce
- How do we allocate **scarce resources**?
- There's no such thing as a ( ).
- What to ( )?



### Themes of Microeconomics

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- Workers, firms and consumers must make ( )
  - Do I work or go on vacation?
  - Do I purchase a new car or save my money?
  - Do we hire more workers or buy new machinery?
- How are these trade-offs best made?



### Themes of Microeconomics

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- Consumers
  - Limited incomes
  - **Consumer theory** – how consumers maximize their well-being (happiness), subject to their limited income?



### Themes of Microeconomics

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- Workers
  - Individuals decide when and whether to enter the work-force
    - Trade-offs of working now or obtaining more education/training
  - How many hours do individuals choose to work?
    - Trade-off of labor and leisure

## Themes of Microeconomics

- Firms

- What types of products do firms produce?
  - Constraints on production capacity & financial resources create needs for trade-offs.
- Theory of the Firm – how these trade-offs are best made

## Themes of Microeconomics

- Prices

- How are prices determined?
- ( ) – collection of buyers and sellers whose interaction determines the prices of goods.
- Invisible Hand

## Theories and Models

- Economics is concerned with explanation of observed phenomena

- Theories are used to explain observed phenomena in terms of a set of basic rules and ( ).
- Why? => Because....
- Story Telling
  - Cf. B & G
- Cause & Effect

## Theories and Models

- Theories are used to make explanations and predictions.

- Economic models are created from theories
- Models are made based on some set of assumptions for simplification.
- ( ) are mathematical representations used to make quantitative predictions.
- Validity of economic models?
  - Reality of assumptions?

## Theories and Models

- Validating a Theory

- The validity of a theory is determined by the power of its ( ), given the assumptions.
- Theories must be tested and refined
  - Statistics, Econometrics,
- Theories are imperfect – but give much insights into observed phenomena

## Positive & Normative Analysis

- Positive Analysis – statements that describe ( )

- Questions that deal with explanation and prediction
  - What will be the impact of an import quota on foreign cars?
  - What will be the impact of an increase in the gasoline excise tax?
- “What is”



## Positive & Normative Analysis

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- **Normative Analysis** – examining questions of **what ought to be**
  - Often supplemented by ( )
    - Should the government impose a larger gasoline tax?
    - Should the government decrease the tariffs on imported cars?

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## What is a Market?

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- **Markets**
  - Collection of buyers and sellers, who determine the prices of products through their interactions.
- **Arbitrage**
  - The practice of buying a product at a low price in one location and selling it for more in another location

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## What is a Market?

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- Most of the questions in economics concern the functioning of markets
  - Why are there a lot of firms in some markets and not in others?
  - Are consumers better off with many firms?
  - Should the government intervene in markets?

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## Market

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- **Market Definition**
  - Which buyers and sellers should be included in a given market
  - This depends on the **extent of the market** – boundaries, geographical and by range of products, to be included in it
    - Market for housing in New York or Indianapolis
    - Market for all cameras or digital cameras

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## Why Study Microeconomics?

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- Microeconomic concepts are used by everyone to assist them in **making choices as consumers and producers**.
- Examples show the numerous levels of microeconomic questions necessary in many decisions

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## Ford SUV's

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- Ford built Ford Explorer in 1991, Ford Expedition in 1997 and the Ford Excursion in 1999
- In each of these cases, Ford had to consider many aspects of the economy to ensure their introduction was a sound investment

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## Ford SUV's

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- Questions
  - How strong is demand and how quickly will it grow?
  - What are the costs of manufacturing



## Ford SUV's

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- Questions (cont.)
  - Ford had to develop pricing strategy and determine competitors reactions.
  - Risk analysis
    - Uncertainty of future prices: gas, wages
  - Organizational decisions
    - integration of all divisions of production
  - Government regulation
    - Emissions standards



## Emission Standards

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- 1970 Clean Air Act imposed emissions standards and have become increasingly stringent
- Questions
  - What are the impacts on consumers?
  - What are the impacts on producers?
  - How should the standards be enforced?
  - What are the benefits and costs?