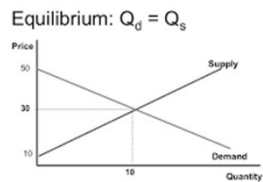


## Microeconomics (W2)



### OUTLINE

- 1) The Themes of Microeconomics
- 2) The three problems of economic organization
- 2) What Is a Market?
- 3) Real versus Nominal Prices
- 4) Why Study Microeconomics?

- **microeconomics** Branch of economics that deals with the behavior of individual economic units—consumers, firms, workers, and investors—as well as the markets that these units comprise.

- **macroeconomics** Branch of economics that deals with aggregate economic variables, such as the level and growth rate of national output, interest rates, unemployment, and inflation.

### THE THEMES OF MICROECONOMICS

#### Trade-Offs

##### Consumers

Consumers have limited incomes, which can be spent on a wide variety of goods and services, or saved for the future.

##### Workers

Workers also face constraints and make trade-offs. First, people must decide whether and when to enter the workforce. Second, workers face trade-offs in their choice of employment. Finally, workers must sometimes decide how many hours per week they wish to work, thereby trading off labor for leisure.

##### Firms

Firms also face limits in terms of the kinds of products that they can produce, and the resources available to produce them.

### THE THEMES OF MICROECONOMICS

#### Prices and Markets

- ❖ Microeconomics describes how prices are determined.
- ❖ In a centrally planned economy, prices are set by the government.
- ❖ In a market economy, prices are determined by the interactions of consumers, workers, and firms. These interactions occur in *markets*—collections of buyers and sellers that together determine the price of a good.

### THE THEMES OF MICROECONOMICS

#### Opportunity cost

- ❖ Scarcity??
- ❖ Making a choice in a world of scarcity requires us to give up something else, in effect costing us the opportunity to do something else. The alternative forgone is called opportunity cost
- ❖ Opportunity cost of a decision arises because choosing one thing in a world of scarcity means giving up something else. The opportunity cost is the value of the good or service forgone

## THE THEMES OF MICROECONOMICS

**The law of diminishing returns**

- ❖ This law concerns the relationship between inputs and outputs in the productive process.
- ❖ The law of diminishing returns holds that an increase in some input, with other inputs held constant, will increase total output. But after some point, the extra output resulting from additional doses of input will tend to become smaller and smaller
  - Ex. 100 acres with no labor = 0 production, 1 labor 50 kg of corn, 2 labor 100 kg of corn, 3 labor 120kg of corn, 4 labor 135kg of corn, 5 labor 145kg of corn, 6+ labor 150kg of corn.
  - The law of diminishing returns is an important and widely observed economic relationship. However, that it is not universally valid for all technologies.

## THE THEMES OF MICROECONOMICS

**Theories and Models**

In economics, explanation and prediction are based on *theories*. Theories are developed to explain observed phenomena in terms of a set of basic rules and assumptions.

A *model* is a mathematical representation, based on economic theory, of a firm, a market, or some other entity.

**Positive versus Normative Analysis**

- **positive analysis** Analysis describing relationships of cause and effect.
- **normative analysis** Analysis examining questions of what ought to be.

## THE THEMES OF MICROECONOMICS

**Positive versus Normative Economics**

- ❖ Positive economics: describe the facts and behavior in the economy.
  - What are the causes of poverty in Thailand?
  - What is the effect of higher cigarette taxes on the number of smokers?
  - These questions can be resolved only by reference to facts
- ❖ Normative economics: involves ethical precepts and value judgments
  - Should government have handouts to the poor?
  - Should the socialist countries introduce private property and stock markets?
  - There are no right or wrong for these question, they involve ethics and values rather than facts
  - These questions are resolved by political decisions, not economic science.

**The three problems of economic organization**

Every human society must face these questions

- 1) What commodities are to be produced and in what quantities, when will it be produced and so on.
- 2) How shall goods be produced? By whom and with what resource and in what technological manner are they to be produced?
- 3) For whom shall goods be produced? Who gets to eat the fruit of the economy's efforts? Or, to put it formally, how is the national product to be divided among different households?

These three basic problems are common to all economies. But, as we will see later, different societies take different approaches in solving them

## WHAT IS A MARKET?

- **market** Collection of buyers and sellers that, through their actual or potential interactions, determine the price of a product or set of products.
- **market definition** Determination of the buyers, sellers, and range of products that should be included in a particular market.
- **arbitrage** Practice of buying at a low price at one location and selling at a higher price in another.

## WHAT IS A MARKET?

**Competitive versus Noncompetitive Markets**

- **perfectly competitive market** Market with many buyers and sellers, so that no single buyer or seller has a significant impact on price.

**Market Price**

- **market price** Price prevailing in a competitive market.

REAL VERSUS NOMINAL PRICES

**The Minimum Wage**

In nominal terms, the minimum wage has increased steadily over the past 70 years. However, in real terms its expected 2010 level is below that of the 1970s.



WHY STUDY MICROECONOMICS?

**Corporate Decision Making: Ford's Sport Utility Vehicles**

The design and efficient production of Ford's SUVs involved not only some impressive engineering, but a lot of economics as well.

First, Ford had to think carefully about how the public would react to the design and performance of its new products.

Next, Ford had to be concerned with the cost of manufacturing these cars.

Finally, Ford had to think about its relationship to the government and the effects of regulatory policies.

WHY STUDY MICROECONOMICS?

**Public Policy Design: Automobile Emission Standards for the Twenty-First Century**

The design of a program like the Clean Air Act involves a good deal of economics.

First, the government must evaluate the monetary impact of the program on consumers.

The government must determine how new standards will affect the cost of producing cars.

Finally, the government must ask why the problems related to air pollution are not solved by our market-oriented economy.

WHY STUDY MICROECONOMICS?

optimization problems



Consumers make buying decisions to maximize utility



Businesses make hiring/capital investment decisions to minimize costs



Businesses make pricing decisions to maximize profits



Consumers make labor decisions to maximize utility



Consumers make savings decisions to maximize utility

We need some tools to analyze these optimization problems