

Lecture # 1 -- What is Microeconomics?

I. What is Microeconomics?

- The main goal of this course is to introduce you to the application of the principles of microeconomic analysis to policy questions.
- Economics is the study of the allocation of scarce resources.
 - Economics is a theory of how markets can be used to allocate scarce resources.
 - However, note that markets are not the only way to allocate scarce resources (e.g. command economy).
 - The article on health care emphasizes that such decisions need to be made, either by the market or by other means.
 - For example, a government board may decide which treatments make the best use of limited resource.
 - Note that even there, costs are an issue.
- Microeconomics studies the interaction among individual economic units.
- Key questions:
 - How to utilize resources most efficiently.
 - What to produce?
 - How to produce it?
 - E.g. how much capital and how much labor
 - How to allocate the goods and services that are produced.
 - In a market economy, goods and services are allocated based on ability to pay.
- Goals for the course:
 1. Develop a theory of the market
 - We'll discuss how the market addresses the above questions.
 - We'll consider how the incentives provided by the market affect behavior.
 - We'll also consider how interventions into the marketplace affect those incentives and change outcomes.
 2. Look at what happens when the market breaks down (e.g. monopoly, pollution, etc.)
 3. Ask what role the government can play in the market.
- The example on CEO salaries illustrates why theory is important
 - Possible remedies depend on the reasons why CEO salaries are high?
 - For advocates who want to address high CEO salaries, is the justification correcting a market failure, or simply about improving equity?

II. A Word About Theory

- Our goal is to explain the world around us and to make predictions.
- Economists use theories and models to do this.
- Model – a mathematical representation, based on theory, of a firm, market or some other economic activity. It describes the relationship between two or more economic variables.
 - Key is to model relevant features, not every detail.
 - Although these theories and models may seem simple, the goal is to focus on only the aspects of the problem that are relevant (remember the model plane example).
- Finally, theories can be tested by doing empirical work.
 - Looking at actual data
 - Need theory to know what to look for
 - Theory leads to predictions that can be tested.

III. Positive versus Normative Economics

- Positive economics -- studies how the economy actually functions.
- Normative economics -- the study of whether or not the economy produces socially desirable results.