

# Intermediate Microeconomic Theory

Introduction and Chapter 1

# About Me

- 4th year Economics Ph.D. student
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- Research: Climate change, job switching, fishing and piracy, housing, marijuana
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# Chapter 1: Introduction

- Microeconomics:

- Definition 1: The study of how decision makers choose among their alternatives in a world filled with constraints
- Definition 2: The study of the allocation of scarce resources
- Definition 3: Price theory

# The Three Questions

- What to produce?
- How to produce it?
- Who gets what is produced?

# Two Different Systems

- Market economy
  - Independent decisions of countless individuals and firms answer the three questions
- Command economy
  - Central authority (often the government) decides

# Scarcity

- Everything is limited!
- Anything worth having that you can think of is scarce
- Since scarcity exists, trade-offs must be made – no free lunch
- Even “free” things carry an opportunity cost

# Trade-offs

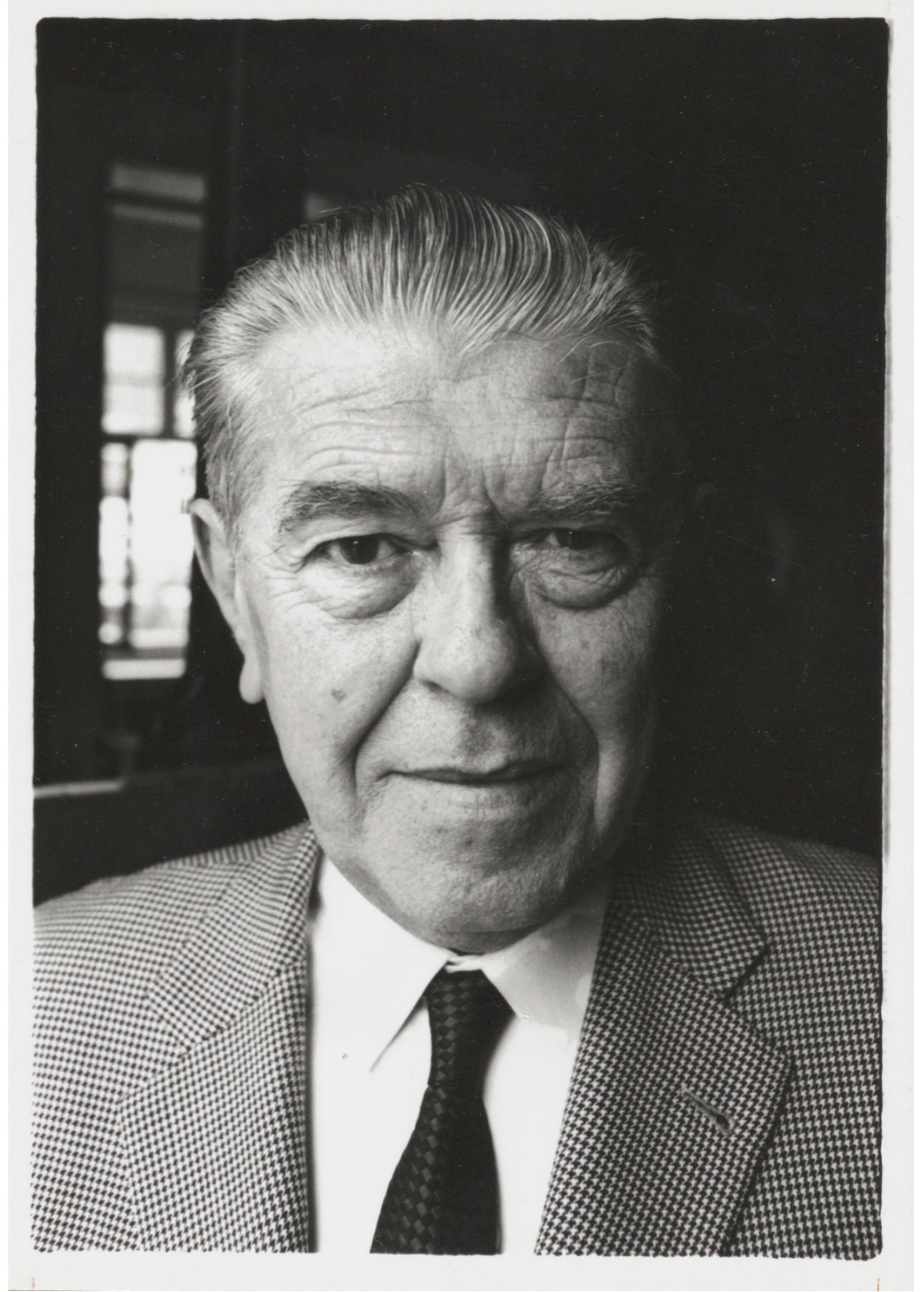
- Consumers: What to buy? How much?  
Should I save? Should I borrow?
- Firms: What to produce? How much? What  
should I charge for it? Should I invest in  
R&D?
- Government: How much to tax? Who  
should we tax? How should we spend the  
tax revenue?

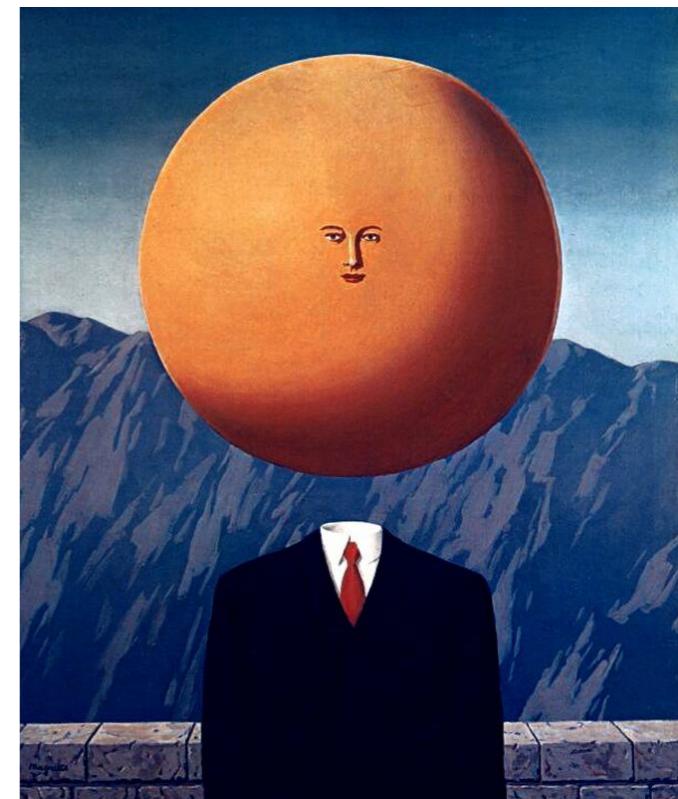
# Prices

- Prices link the three questions in a market economy
- Prices are how a market communicates
- How are prices chosen?

# Models

# René Magritte







*Ceci n'est pas une pipe.*

Magritte

# Models

- “Everything should be made as simple as possible, but not simpler” - Einstein
- Good models:
  1. Outline the relationship between variables
  2. Are useful in describing the past and predicting the future
  3. Leave out LOTS of details that we know exist in the real world – we make assumptions

# How We Use Models

- Consumer and producer behavior
- First model: perfect competition
  - Buyers and sellers have all necessary info
  - Large number of buyers and sellers
  - No transaction costs or entry barriers
  - No externalities
- Perfect competition model too simple

# Using Microeconomic Models

- Apply our simple models to real world scenarios
- We want to explain *why* decisions are made and how choices are affected when a change occurs
  - Airline market when firms merge
  - Housing market after a hurricane
  - Job switching in response to climate change
  - How colonialism affects the legal system in Africa
- Economics is not just about money!

# Positive v. Normative

- Positive statement: can be tested and proven to be true or false
  - Raising the gas tax causes people to drive less
- Normative statement: a statement of value regarding whether something is good or bad, not testable
  - We should tax gas so that people drive less