AS.180.102 (04): Elements of Microeconomics

Chapters 1 and 2

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Introduction

- About me:
  - Kieran Allsop
  - 3rd-year economics PhD student
  - From the United Kingdom
  - Completed my undergraduate degree at Kenyon College, Ohio

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- All sessions will be in person other than Friday September 20th
  - I will send the zoom link during the week beforehand

Outline

This week will cover chapters 1 and 2 of the Mankiw textbook:

1. Ten principles of economics
2. Thinking like an economist

Essentially just a gentle introduction:

- What is economics?
- What do economists do?
- How do economists think?

Main point

Main takeaway from this week:

A little bit of intuition goes a long way.

There is usually a nice everyday analogy for questions in microeconomics.

How People Make Decisions

1. People face trade-offs

There are finite and scarce resources

2. The cost of something is what you give up to get it

Everything has an **opportunity cost**

3. Rational people think at the margin

What will a small change in X do to Y?

4. People respond to incentives

How can we change behavior?

How People Interact

This is the bread and butter of microeconomics!

5. Trade can make everyone better off

Everyone can do what they do best and benefit from other peoples' skills and resources

6. Markets are *usually* a good way to organize economic activity

Markets solve the information problem

7. Governments can improve market outcomes

Market failure can occur as a result of **externalities** and **market power**

How the Economy as a Whole Works

Microeconomics aggregates up to macroeconomics.

8. A country's standard of living depends on its ability to produce goods and services

Why do we see such large differences between countries?

9. Prices rise when the government prints too much money

Too much money chasing too few goods is one cause of inflation

10. Society faces a short-run trade-off between inflation and unemployment.

Greater demand for goods equals higher prices but also greater demand for workers

Trade-offs

You are trying to decide whether to go on a beach trip during your first spring break. What costs do you need to consider?

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1. **Direct Costs**: Dollar cost of the vacation: transportation, food, renting a house ...
2. **Monetary Opportunity Cost**: Money you could make if you worked your part-time job instead
3. **Non-Monetary Opportunity Cost**: Studying you could get done: preparation for finals, work on semester projects, etc.

The Economist as Scientist

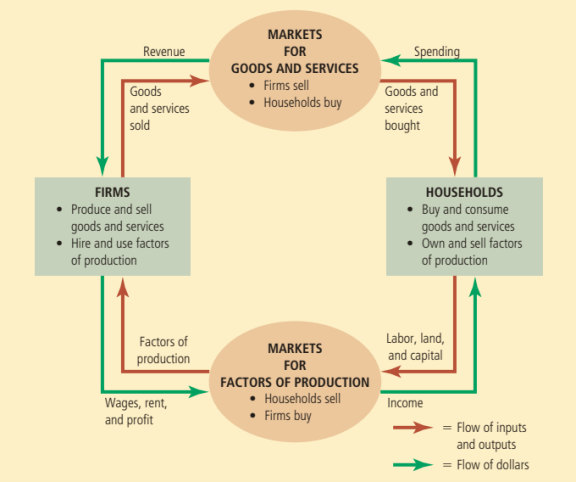
Provocative!

How are economists like scientists? How are economists not like scientists?

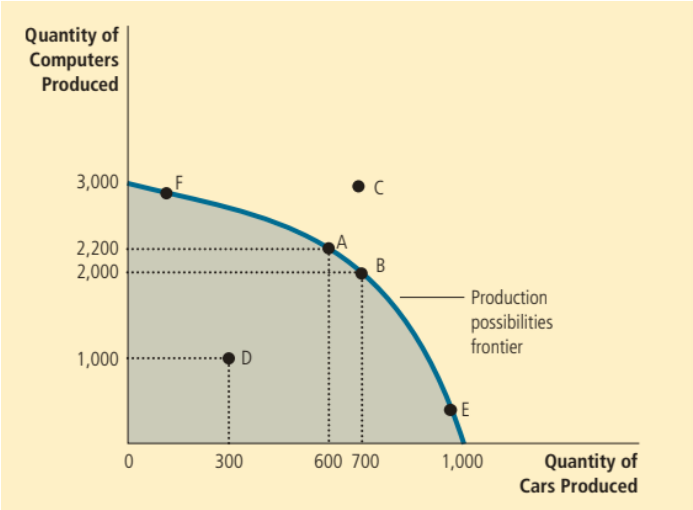
> "Imagine how much harder physics would be if electrons had feelings."
> - Richard Feynman, theoretical physicist

Economists work with models, which rest on assumptions. Let's look at a few.

Circular flow



Production possibility frontier



PPF of a firm

Let's start an Italian restaurant that makes pizzas and sandwiches.

1. What will our production possibility frontier look like?
2. Why will it take the shape that it has?
3. How can we read the opportunity cost? Does it matter which part of the PPF we look at?
4. Why might the shape change over time?

CPF of an individual

Now suppose we are *going* to the Italian restaurant with a group of friends, and we want to decide what to order. Pizzas are \$10, sandwiches are \$5, and we have \$100 to spend.

1. What will our consumption possibility frontier look like?
2. What is the opportunity cost of a pizza? Does it matter where on the CPF we are?
3. What will happen to the CPF if we have \$200 to spend?
4. What will happen to the CPF if the price of sandwiches increases to \$10?

Circular-flow diagram of the Italian restaurant economy

Suppose the entire economy consists of Italian restaurants: during half of the week we work in one, and during the other half we buy food from them.

- What does the circular-flow diagram look like?
- What is missing from our model?

Economists, economics, and economic reality

Economists are often asked to guide economic policy.

- What are positive and normative statements?
- Why might two economists make different suggestions?
- Why might politicians ignore economists' suggestions?