Topic 1: Principles of Microeconomics

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Readings
- Chapter 1
- Appendix A

What is Economics?

Economics is a social science as psychology, sociology, political science, etc.
But the better answer is: **The study of choices made by agents in the face of scarcity.**
These "agents" may be people, institutions, firms, governments, etc.

Normative vs. Positive Economics

Normative: **What should happen**
Positive: **What will happen**

Economists focus on the **POSITIVE** statements *NOT* the normative statements.

10 Basic Principles

Principle 1: Scarcity and Costs

Scarcity refers to the inability to satisfy all desires because resources are unavailable but finite
Scarcity is everywhere

Example: Movies

Movies are expensive
- There are two costs:
  - Actual dollar paid
  - Time spent in the movie
- Both of these "costs" are scarce

In this case, time is an example of an *opportunity cost*
- **Opportunity cost** is the value of the next best alternative not consumed
  - i.e. the best alternative of what you could have done with your time

★ You will NEVER get your "money's worth"

Principle 2: Incentives

Scarcity and costs create "*incentives*" which guide people's decisions

★ Incentives are extremely powerful

Principle 3: Behavior on the Margin

People think about whether or not to have one more of something
- i.e. you care about the value of an additional unit, which we call *marginal value*

Firms also make decisions on the margin
- Worry about the cost of producing an additional unit, the *marginal cost*, and how much they can sell that additional unit for, the *marginal revenue.*

Principle 4: Efficiency

If resources are scarce, the next question is how should those resources be allocated to satisfy limitless wants and needs?
- The answer is that *resources should be allocated efficiently*

Pareto Efficiency: an allocation of resources is efficient if the resources cannot be reallocated to help someone without hurting someone else

Efficiency is NOT the same as equity.
- Whether an allocation is fair is a normative question.

Principle 5: Markets

A market is an arrangement that allows buyers and sellers to interact and exchange goods and services.

Markets solve the economic problem - meaning that they allocate resources efficiently when they work correctly.
- Prices are key!
  - Prices act as a signal of what to produce, create incentives for some firms to produce, and determine who buys the product

Principle 6: Government can help or hurt

Taxes, subsidies, quotas, and price controls are ways in which governments intervene in markets.

If markets are functioning efficiently then government interventions tend to mess things up

If markets are *NOT* functioning efficiently then the government may be able to make things better.