Introduction to Microeconomics

Topic 1: Basic Concepts & Principles

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What is Economics all about?

How **FIRMS** decide how much to produce, how many workers to hire

How **SOCIETY** decides how to divide its resources between national defense, consumer goods, protecting the environment, and other needs

How **CONSUMERS** decide what to buy, how much to work, save, and spend

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So how would you define Economics?

- the study of how **INDIVIDUAL**, **FIRMS** and **SOCITIES** use **LIMITED RESOURCES** to satisfy **UNLIMITED WANTS**.

That's my GIRL?

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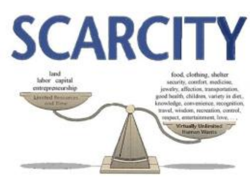
The Fundamental Economic Problem



When material NEEDS and WANTS exceed our ability to fulfill them due to LIMITED RESOURCES!

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How do People Choose or Make Decisions?

- **Economics is a study of how people make decisions**
- **Our Economic Decisions involve:**
  - Trade-offs
  - Efficiency vs. Equity
  - Opportunity Cost
  - Marginalism
  - Incentives

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Principles of How People Make Decisions

Principle 1: People Face Tradeoffs

- All decisions involve tradeoff

 OR 

 OR 

 OR 

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Principles of How People Make Decisions
Principle 2: Society Face Tradeoffs

- Society faces an important tradeoff

Allocative Efficiency:
An efficient economy is one that produces what people want at the least possible cost.

Equity:
An equitable economy is one that has fairness of economic outcomes

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Principles of How People Make Decisions
Principle 3: The Cost of Something Is What You Give Up to Get It

- Making decisions requires comparing the costs and benefits of alternative choices

Opportunity cost is the best alternative that we forgo, or give up, when we make a choice or a decision.

Opportunity Cost

Principles of How People Make Decisions
Principle 4: Rational People Think at the Margin

- In weighing the costs and benefits of a decision, it is important to weigh only the costs and benefits that arise from the decision.

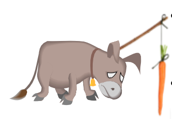
Marginalism: *Considers only the **additional cost (MARGINAL COST), NOT** the **SUNK COST.***

HOME	Which Bank?	HOME
Interest		Interest
Principal		Principal

Principles of How People Make Decisions
Principle 5: People Respond to Incentives

- Rational People Respond to Incentives

Incentive: what people get for doing something



- When gas prices rise, consumers buy more hybrid cars and fewer gas guzzling SUVs
- When MEGA-SALE comes, we buy things we don't need

- ***Remunerative (financial, share of profits)***
- ***Moral Incentives (guilt, self esteem)***
- ***Coercive Incentive (punishment, shame)***
- ***Natural Incentive (pain, joy, fear)***

Microeconomics HM207

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