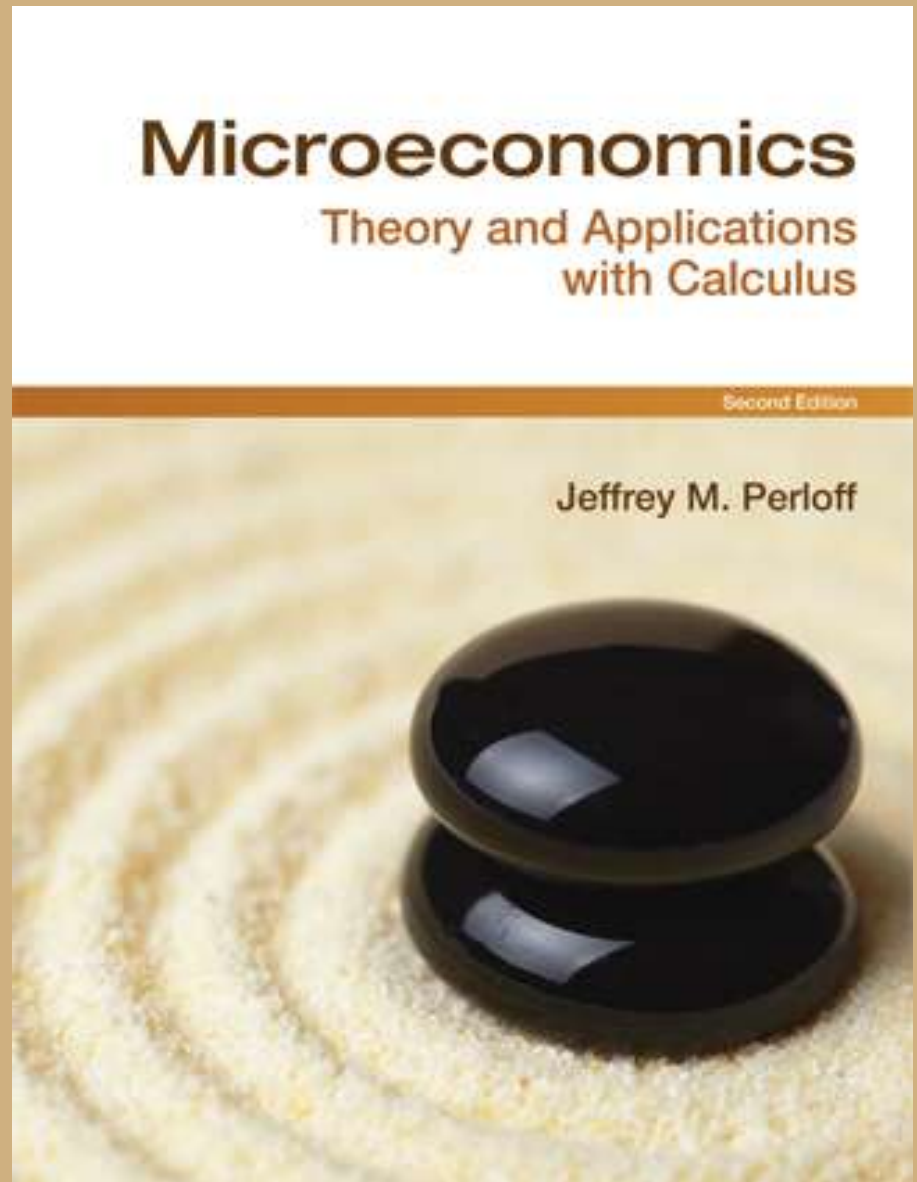


Chapter 1

Introduction

I've often wondered what goes into a hot dog. Now I know and I wish I didn't.

William Zinsser



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Chapter 1 Outline

- 1.1 Microeconomics: The Allocation of Scarce Resources
- 1.2 Microeconomic Models
- 1.3 Uses of Microeconomic Models

1.1 Microeconomics: The Allocation of Scarce Resources

- Scarcity implies trade-offs
 - Resources (workers, raw materials, capital, and energy) are available in limited supply.
 - Which goods and services should be produced?
 - How should we produce those goods and services?
 - Who gets to consume those goods and services?
- Decision-makers
 - Individuals (consumers)
 - Firms
 - Government

1.1 Microeconomics: The Allocation of Scarce Resources

- Prices determine resource allocation
 - Which goods? How to produce? Who gets them?
 - Prices answer these important questions by influencing decision-makers.
- Markets
 - A market is where interactions between consumers, firms, and the government occur.
 - Prices of goods and services are determined in a market.
- Applications
 - Flu vaccine
 - Twinkie tax

1.2 Microeconomic Models

- A model is a description of the relationship between two or more economic variables.
 - Understanding this relationship allows economists to predict how a change in one variable will affect another variable.
- Economic models:
 - have assumptions that simplify things relative to the real world
 - make theoretical predictions that we can test empirically
 - involve maximizing something (e.g. consumer satisfaction, firm profits) subject to resource constraints
 - are used to make **positive** rather than **normative** statements
 - The truth of a ***positive*** statement can be tested.
 - A ***normative*** statement contains a value judgment that can't be tested.

1.3 Uses of Microeconomic Models

- Predicting individual decisions
 - Why do individuals prefer cash to food stamps? (Ch. 4)
 - How does inflation affect individuals' purchases? (Ch. 5)
 - Does it pay financially to go to college? (Ch. 15)
- Predicting firm decisions
 - How can firms' pricing strategies increase profits? (Ch. 12)
 - Should Coca-cola advertise more if Pepsi does? (Ch. 13)
- Predicting government decisions
 - Can price controls cause life-threatening food shortages? (Ch. 2)
 - Is a country better off using tariffs or quotas? (Ch. 9)
 - How can pollution taxes reduce global warming? (Ch. 17)