August 22. Introduction

Principles of Microeconomics
ECON 10011 / 20011
Fall 2006, Tuesdays and Thursdays, 11-12.15

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Course Requirements and Grading

Final grade based on:
1. Three exams on days mentioned in the syllabus. Two best scores will be considered (drop lowest) - total 40 points
2. Comprehensive final exam - 30 points
3. In-class quizzes – 20 points
4. Home work – Home work advantage – and one short class project - 10 points. Class project involves choosing one topic of relevance to this course from a newspaper or magazine article and writing a 2-3 pg. report on it using tools developed in this class. Due by December 5 but may be handed in any time – as attachment to email.

Textbook:
Microeconomics
Krugman and Wells
with Micro-Homework Card-Student CD-iClicker

Homework

There will be daily assignments. You will be required to
1. Read the reading on the chapter covered in the previous class and for the next class
2. Use student tools, especially practice quizzing center at http://bcs.worthpublishers.com/krugmanwellsmicro/
3. Work on the assigned problem set posted at http://bfw.brownstone.net/classes/admicro/
On that site you have to
1. register as a student
2. Enter your Homework advantage center activation code
3. Register as a student
4. Do homework problem by given time and date; check time limit before starting

In-class quizzes

- To be held almost daily
- Need to use i-clickers; must be in class and bring i-clicker every day
- On material covered during the previous class
- Lowest 4 grades from quizzes will be dropped for each student
- Today you will register your i-clickers
- Let me know if you have any problems or questions

Introduction

- Economics and the Economy
- Market and command economies
- Microeconomics and macroeconomics
- Individual choice
  1. Scarce resources
  2. Opportunity costs
  3. Marginal decisions
  4. Exploiting opportunities
- Interactions
  1. Gains from trade
  2. Equilibrium
  3. Efficiency and equity
  4. Markets and efficiency
  5. Market failure and government intervention
- Applications
Economics and the Economy

- What is economics?
  - Alfred Marshall: “a study of mankind in the ordinary business of life”.
- What is ordinary business?
  - Consuming, producing, working, trading, saving, investing
- The study of the economy

Market and command economies

- Two polar types of economies: market and command economy
- Market economy: production, consumption and other decisions made by individuals with markets coordinating activities
- Command economy: a central authority makes economic decisions.
- Ideal cases, but US is close to a market economy and former Soviet Union close to a command economy.

Market and command economies, cont.

- In market economies individuals make their own decisions
- They interact with each other through markets, buying and selling
- An outcome occurs
- Is the outcome good or bad?
- If there are some bad things, what can be done?
- In particular, what can government policy do?
- Some element of command economy comes in here.

Microeconomics and Macroeconomics

- Microeconomics: studies how individuals make decisions in particular markets and the implications of such interactions.
- Macroeconomics: studies the behavior of economic aggregates like GDP, total consumption, unemployment, inflation, growth rate of the economy.

Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776: “Every individual necessarily labors to render the annual revenue of the society as great as he can. He generally indeed neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.”

But markets can produce poor outcomes too, as we shall see.
Individual choice: Scarce Resources
- Individuals make choices among alternatives – because income and time are limited
- Ultimate reason why individuals have to make choices is that resources are scarce
- Resources: something used to produce something else – land, labor, capital (machinery, buildings), human capital (education and skills of workers)
- Societies also make choices

Individual choice: Opportunity Cost
- Refers to the real cost of something
- It is what you must give up to get that something
- Refers to the best alternative you give up
- All costs are opportunity costs: When you come to college, not just the money cost, but also the value of what you give up - like a job.

Individual choice: Marginal decisions
- Most decisions are not just whether you do something or not, but how much of something you do.
- How much of something depends on the evaluation of decisions at the margin – what is the additional benefit and additional cost of doing it? Additional time spent, additional dollar spent, on something or some activity. Marginal, rather than total, analysis.
- Examine trade-offs – a comparison of additional benefits of doing something rather than something else.

Individual choice: Exploiting opportunities
- How much of something will people do?
- People usually exploit opportunities that make themselves better off: if marginal benefit exists marginal cost – they will do more of it.
- People respond to incentives: something that offer rewards to people who change their behavior
- If they are already doing their best, they will change their behavior if new opportunities open up.
- Of course, they may not know all about the additional benefits or costs

Interactions: Gains from Trade
- People trade
- People often gain from trade
- Specialization – Adam Smith’s pin factory
  - Doing specific things
  - Different people can do different things better than others
- Why we choose careers

Interactions: Equilibrium
- Equilibrium refers to a situation of rest: swing analogy
- In microeconomics refer to a situation when individuals cannot change their behavior in a way that makes themselves better off, given their environment (and what others are doing). Checkout lines
- In economics we usually study equilibrium – ignore complex movements
- Warning: sometimes movements can determine where we will end up. Some examples of this later in the course
Interactions: Efficiency and equity
- What do we mean when we say that an economic outcome is good?
- Efficiency is one criterion. Efficiency means that an economy's resources are used in such a way that all opportunities to make people better off are exhausted. So you can only make some people better off by making someone else worse off.
- Another criterion many economists take into account is equity. Make attention to who gets what. Ensure that some people don't get too little. Fairness issue.
- The two may be in conflict. But don't have to be.

Interactions: Markets and efficiency
- Markets often lead to efficiency.
- Individuals make decision to do as well as they can for themselves. They will not let go of opportunities. This, under certain conditions, will lead to efficiency.
- This is the idea of the invisible hand
- But under some conditions it may not

Interactions: Market failure and government intervention
- Markets may not lead to efficiency in some cases – we then have market failures
- Examples of market failures
  - Side effects or externalities
  - Powerful parties capture more resources for themselves and lead to inefficiencies
  - Some goods by their nature cannot be supplied by individuals in markets – called public goods
- Also, the market outcome may be inequitable
- In such cases government intervention can improve matters
- Doesn't mean that it it will necessarily – some governments may be incapable, others corrupt – government failures

Application
- Economic miracles in East Asian economies
- Rapid growth and improvements in living standards
- Role of markets
- Role of the government

Homework and next class
- Do readings for today - Introduction and Chapter 1
- Test next class
- Do homework
- Next chapter: Economic Models - read ahead

The End of Chapter 1
coming attraction:
Chapter 2: Economic Models: Trade-offs and Trade