# What does microeconomics study?

- Explore the decision making of economic agents (consumers and firms)
- Examines how different market mechanisms operate to allocate resources.

# Why microeconomics?

- Predict market equilibrium under a change in market condition / policies (counterfactual analyses)
- Market equilibrium (price, quantity)
- Market condition
- Consumer preference
- A change in firm numbers, technology
- A change in market structure: e.g. competition imperfect competition or collusion

# Why microeconomics?

- Evaluate the impact of a policy
  - Social welfare (consumer welfare, firm profit, government revenue, externality etc.)
  - Pareto optimal
- Antitrust
  - Merger / acquisition
  - Price discrimination
  - Market definition

# Course description

1. Consumer Theory (demand)
2. Production Theory (supply)
3. Market Equilibrium
    1. Perfect Competition
    2. Imperfect Competition
4. Externalities, Public Goods
5. Game Theory

# Consumer Theory

1. Budget
2. Preference ➔ Utility function
3. Optimal choice (individual demand)
    1. Utility maximization under budget constraint
4. Market demand (sum of individual demand)

# Production Theory

1. Technology
2. Profit maximization
3. Cost minimization given output level
4. Firm supply
5. Industry supply (sum of individual firm supply)

# Market equilibrium

- Market demand = Industry supply ➔
  - Equilibrium price and quantity
- Different markets
  - Perfect competition
    - Features: many consumers and firms
  - Imperfect competition
    - Features: few firms
    - Monopoly
    - Oligopoly

# Example: Apartment Market

- Who will rent close apartments in a college town?
- At what price?
- Will the allocation of apartments be desirable in any sense?

- How can we construct an insightful model to answer these questions?

# Modeling

* Eliminate irrelevant detail and focus on the essential features to understand

* Exogenous variables
  * Determined by factors not discussed in the model
* Endogenous variables
  * Determined by forces described in the model

# Economic Modeling Assumptions

- Two basic principles:
  - Optimization: People try to choose the best patterns of consumption that they can afford.
  - Equilibrium: Prices adjust until quantity demanded equals quantity supplied.

# Example: Apartment Market

- Demand: Suppose the most any one person is willing to pay to rent a close apartment is \$500/month. Then
- $p = \$500 \Rightarrow Q^D = 1.$
- Suppose the price has to drop to \$490 before a 2nd person would rent. Then
- $p = \$490 \Rightarrow Q^D = 2.$

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