



Lecture 5

- **Why is microeconomic theory important/interesting?**
- **Positive vs. normative analysis**
- **Basic concepts**
(Excluding demand/supply, elasticity, and market mechanism, to be discussed next time)



Important Questions

- **Corporate decision making:**
 - Shall we introduce a new product?
 - What kind of product will sell well?
 - What price should we charge?
 - How much advertising do we need?
- **Public policy design:**
 - Should the government control prices and/or quantities sold?
 - Should the government tax or subsidize an industry?
 - Should the government set a standard?



Positive vs. Normative Analysis

- **Positive:**
 - explain and predict
 - focus on efficiency
- **Normative:**
 - ideal choice
 - focus on both efficiency and equity or other value judgements
- **Microeconomics focuses on positive analysis and provides trade-offs for normative analysis**



Basic Concepts

- **Rationality:**
 - Each buyer/seller maximizes its objective function, utility or profit function
- **Market:**
 - A place where potential rational buyers and sellers meet to decide a product's price and quantity sold
- **Real vs. nominal prices:**
 - Nominal: the price we observe
 - Real: the relative price to a set of goods
 - Example: nominal vs. real wage