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