Let's Talk about Microeconomics

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Introductory Notions

This book is addressed to all those who want to make a venture into the world of Microeconomics.

The authors

Each science has its own language and way of thinking. The economy is no exception to this reality. For example, economists use their own concepts: supply and demand, elasticity, comparative advantage, consumer surplus, and social loss.

Economists try to approach their analyzes with specific objectivity science: they formulate a theory, collect data, and then analyze the data to check if the formulated theory is supported or rejected.

In essence, ***Microeconomics is about scarcity,*** about how individuals and companies make decisions in the context of scarce resources. The idea is to optimize these constraints and make compromises between different alternatives to make the best decision. It can be affirmed that the label of "dismal science" results from here = gloomy science - because you cannot have anything, anytime, but you must make a compromise, you have to give X to have Y. For example, if Dan has only one apple, he cannot eat the apple and, at the same time, make apple jam.

Emphasis is placed on two types of actors in the economy, ***Consumers*** and ***Manufacturers***, whose behaviors can be described by different models (which, in essence, approximate, do not necessarily give precise results, as they are obtained for example in physics or other sciences. exact); they start from certain hypotheses and can provide support for describing a general trend.

- **Consumers** are constrained by income (budget constraint), depending on which they choose the goods they consume, to maximize their usefulness, so the assumption from which to analyze consumer behavior is to maximize utility in the context of limited income.

• On the other hand, **companies** seek to maximize profits, constrained by both consumer demand and production costs (costs with factors of production).

Therefore, the four fundamental questions of Microeconomics arise:

1. What goods and services need to be produced?
2. How much should be produced?
3. How should they be produced?
4. For whom?

The answer to these questions is provided by the price mechanism, prices that are formed in the market (market of factors of production, market of goods and services), by meeting demand with supply, and according to which companies and consumers make decisions.

Simply put, prices serve as signals that allocate resources. High-demand goods have high prices, and low-demand goods have low prices. Because companies usually want to increase their profits, they follow the evolution of price signals in the markets and will produce more of the goods that have high prices and less of those that have low prices. In this sense, markets tend to allocate limited resources efficiently and use them to produce the goods that people want most, or at least for which people are willing to pay the most.

However, there are some issues/limitations in terms of markets. First, markets produce any goods/services that people are willing to pay for, even if they are not necessarily good for people or the environment. Second, markets are amoral: they do not guarantee fairness or fairness.

As presented above, Microeconomics refers to scarcity - or how individuals and firms make decisions and meet their needs, in the context of the availability of scarcity resources. The problem is how to optimize these constraints and make trade-offs between different alternatives to make the best decision.

Positive and normative economy

The positive approach to Economics describes and explains the real economic phenomena. It seeks to identify the relationships between economic variables, to quantify, to measure these relationships, and to make predictions. He deals with "what is" and answers the question "Why?"

Example:

- An increase in income tax leads to a reduction in consumer spending (?);
- The inflation rate in August 2021 was 7.8% and, ceteris paribus, the purchasing power of the population decreased (?);
- The real earnings index for June 2021 compared to the previous month, calculated as a ratio between the net nominal earnings index and the consumer price index, was 95.7%.

As you can see, these are positive statements, based on verifiable facts in real life, as it happens.

Now, if you are a policy maker (government) trying to find the best way to reduce, for example, infant mortality (or reduce youth unemployment, combat tax evasion, distribute more equitably) educational opportunities, etc.), it is important to obtain the best positive economic analysis of each policy alternative that is considered. First, it is important to know what the real impact of each policy will be before trying to choose the ‘best’ policies. The same is true if you are an entrepreneur trying to determine the selling price of a good; you need to know how people will respond at different prices, not just how you would like them to respond.

The normative economy shows how economic activities should be conducted. It operates with value judgments, with assessments based on many other criteria than economic ones (such as those related to equity, ethics, ideology). He deals with "what should be" and answers the question ‘How?’

The normative economy thus goes beyond the analysis of simple facts and what happens if incentives/conditions change. After the positive economist presents their best prediction of what will happen because of possible policy alternatives, a normative economist will try to use tools that include explicit value judgments about what results are 'good' and what results are 'bad' to determine what is the best policy for society.

Therefore, normative economists use disciplines such as political philosophy or ethics to formalize mechanisms to translate particular values into policy recommendations based on a positive analysis of the expected impact of different incentives.

Example:

• High-income businesses should pay higher taxes than low-income ones;

• Romania should charge higher tariffs on car imports;

The examples of normative statements presented above represent two classic issues: the issue of equity and the issue of protectionism. Let us look at the second situation. Economists normally consider that free trade (trade between countries without restrictions - taxes, regulated quantities - on imports or exports) is a good thing, because, in general, welfare increases, prices fall (being a higher supply) and consumers benefit from better, cheaper, and more varied products.

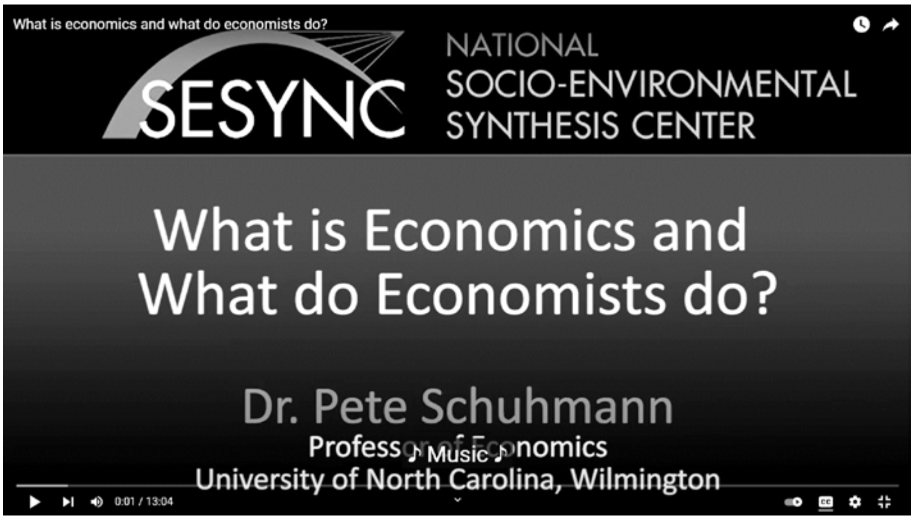
At the same time, it is possible that many domestic companies will leave the market because of the entry of more competitive foreign companies with better products. Because they cannot cope with the competition, some local companies are forced to stop working and lay off their employees. Normally, there is an increase in unemployment in the national economy.

Noticing these negative effects of free trade, the government decides to impose taxes on the import of goods. The number of foreign companies decreases, the total supply of goods decreases, domestic prices increase, and the welfare of consumers is assumed to have decreased. However, the jobs of domestic companies have been protected and the policy has achieved its goal. As it turns out, there is a significant evil, even if the best option was chosen.

Another way of looking at things or an alternative overview on this topic: online resources

Should You Become an Economist?:
https://www.youtube.com/watch?v=kKnRq6u5Z9Y

What is Economics and What do Economists do?:
https://www.youtube.com/watch?v=VxGwVEqPm_k



What is Economics?:

https://www.youtube.com/watch?v=nWPrMmv1Tis

Why Should I Study Economics?:

https://www.youtube.com/watch?v=2sfohnSTFAw