ECO. 305: MICROECONOMICS AS A SCIENTIFIC THEORY

What Is Microeconomics All About?

Microeconomics deals with the elemental economic units--individual consumer's and consumers as a group, individual producer's (firm's), industries, commodities, and markets. In microeconomics, therefore, the main objective is the systematic study of the complex interactions of consumers and producers, and the way in which these interactions influence the flow or exchange of goods and services as well as factors of production (inputs) in a given society operating under a set of well defined social behaviors and institutional rules.

To carry the study of microeconomics in a rather simple and systematic manner, we need to explicitly specify the general behavior of the consumers and producers as well as the institutional frameworks (environment) under which economic decisions are being undertaken.

Basic Assumptions About the Consumers and Producers Behaviors and the Market:

1) The **"economic man"** is **rational**. This assumption implies not necessarily "good" judgment rather consistency in the judgment, action or motivation of an economic agent (a consumer or a producer). This is a necessary condition for the **predictability** of the actions of consumers and producers in their roles as economic agents.

2) The **"Self-Interest Hypothesis"**--which suggests that both consumers and producers tend to engage in an economic activity for the sole purpose to advancing their own self-interest. More specifically, the consumers' objective is directed towards **maximizing utility**, whereas, the objective of the producers' is geared towards **maximizing profit.** Does self-interest implies selfishness?

3) The **existence of a well-functioning market.** In standard microeconomics theory, it is generally assumed that all goods and services as well as factors of productions are exchanged through market. In other words, market exists for all commodities. In addition, ideally, we would like the market to be characterized by a high degree of **competition.**

On the basis of the above assumptions we may draw the following conclusion: Self-interest explains how individual acts, and market provides the arena in which self-interest is expressed. But, the economic activities expressed by self-interest would be appealing (or workable) provided that **property rights** are clearly specified.

Basic Assumption About Property (Ownership) Rights:

In standard microeconomics theory, it is assumed that all goods and services as well as factors of production have a **clearly delineable property (ownership) rights.** That is, ownership rights are:

a) Completely specified
b) Exclusive
c) Transferable
d) Enforceable

This assumption is necessary because it is only when the rights of ownership are fully protected and specified that incentives based on self-interest can be efficiently exploited and consistent with the interest of the society at large. In other words, Adam Smith's dictum of the **"invisible hand theorem"** is achievable only when this assumption is satisfied.