

# Chapter 2: Economic Models and Review

Abel Embaye

Department of Economics

UofA

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# Objectives

- What Microeconomics Is All About
- What Micro-economists Do and the tools they use
- Some important concepts in microeconomic analysis
- Organization of the Course

# Issues Addressed in microeconomics

**Microeconomics:** is the study of individual decision making units (households, firms and government), their interaction in a the market and the implication for the allocation of scarce resources.

- decision of household: buying of goods, saving for retirement and other decisions
- decision of firms: what goods and services to produce
- decision of government: provision of public good

# Thinking like microeconomists: Models

- Economists use models to think about economic issues
- Models are simplified versions of a more complex real world- irrelevant details are taken out (using assumptions)
- model are used:
  1. to show relationships between variables and explain economic phenomenon
  2. to predict outcomes under different env't: policies to improve economic performance

# Example of a model: Supply & demand for Gasoline

- Use of the model: to explain how various variables affect the price and quantity of gas at the pump.
- Main Assumptions: Competitive setting

## Demand: individual

- The individual demand shows the relationship between quantity demanded and price, other things equal.
- demand equation:  $Q_d = D(P, P_C, Y)$

where:

$Q_d$  = quantity of gas that buyers demand

$P$  = price of gas per gallon

$P_0$  = price of car, a complement

$Y$  = buyer's income

$D()$  = "function of"