**Text 4. Read and translate the text**

**Microeconomics**

Since Keynes, economic theory has been of two kinds: macroeconomics (study of the determinants of national income) and traditional microeconomics, which approaches the economy as if it were made up only of business firms and households (ignoring governments, banks, charities, trade unions, and all other economic institutions) interacting in two kinds of markets – product markets and those for productive services, or factor markets. Households appear as buyers in product markets and as sellers in factor markets, where they offer human labour, machines, and land for sale or hire. Firms appear as sellers in product markets and as buyers in factor markets. In each type of market, price is determined by the interaction of demand and supply; the task of microeconomic theory is to say something meaningful about the forces that shape demand and supply.

Firms face certain technical constraints in producing goods and services, and households have definite preferences for some products over others. It is possible to express the technical constraints facing business firms through a series of [production functions](https://www.britannica.com/topic/production-function), one for each firm. A production function is simply an equation that expresses the fact that a firm’s output depends on the quantity of inputs it employs and, in particular, that inputs can be technically combined in different proportions to produce a given level of output. For example, a production engineer could calculate the largest possible output that could be produced with every possible combination of inputs. This calculation would define the range of production possibilities open to a firm, but it cannot predict how much the firm will produce, what mixture of products it will make, or what combination of inputs it will adopt; these depend on the prices of products and the prices of inputs (factors of [production](https://www.britannica.com/topic/production)), which have yet to be determined. If the firm wants to [maximize](https://www.britannica.com/topic/profit-maximization) profits (defined as the difference between the sales value of its output and the cost of its inputs), it will select that combination of inputs that minimizes its expenses and therefore maximizes its revenue. Firms can seek [efficiencies](https://www.merriam-webster.com/dictionary/efficiencies) through the production function, but production choices depend, in part, on the demand for products. This leads to the part played by households in the system.

Each household is endowed with definite “tastes” that can be expressed in a series of “[utility functions](https://www.britannica.com/topic/utility-measure).” A utility function (an equation similar to the production function) shows that the pleasure or satisfaction households derive from consumption will depend on the products they purchase and on how they consume these products. Utility functions provide a general description of the household’s preferences between all the paired [alternatives](https://www.merriam-webster.com/dictionary/alternatives) it might confront. Here, too, it is necessary to assume that households seek to maximize satisfaction and that they will distribute their given incomes among available consumer goods in a way that derives the largest possible “utility” from consumption. Their incomes, however, remain to be determined.

In economic theory, the production function contributes to the calculation of [supply curves](https://www.britannica.com/topic/supply-curve) (graphic representations of the relationship between product price and quantity that a seller is willing and able to supply) for firms in product markets and [demand curves](https://www.britannica.com/topic/demand-curve) (graphic representations of the relationship between product price and the quantity of the product demanded) for firms in factor markets. Similarly, the utility function contributes to the calculation of demand curves for households in product markets and the supply curves for households in factor markets. All of these demand and supply curves express the quantities demanded and supplied as a function of prices not because price alone determines economic behaviour but because the purpose is to arrive at a theory of price determination. Much of microeconomic theory is devoted to showing how various production and utility functions, coupled with certain assumptions about behaviour, lead to demand and supply curves such as those depicted in the figure.

**Questions:**

1. What is economic theory divided into?
2. What are the functions of the households in the economy?
3. How is price determined in the market?
4. What is a utility function?
5. What is demand and supply in the economics theory and what functions do the have?