

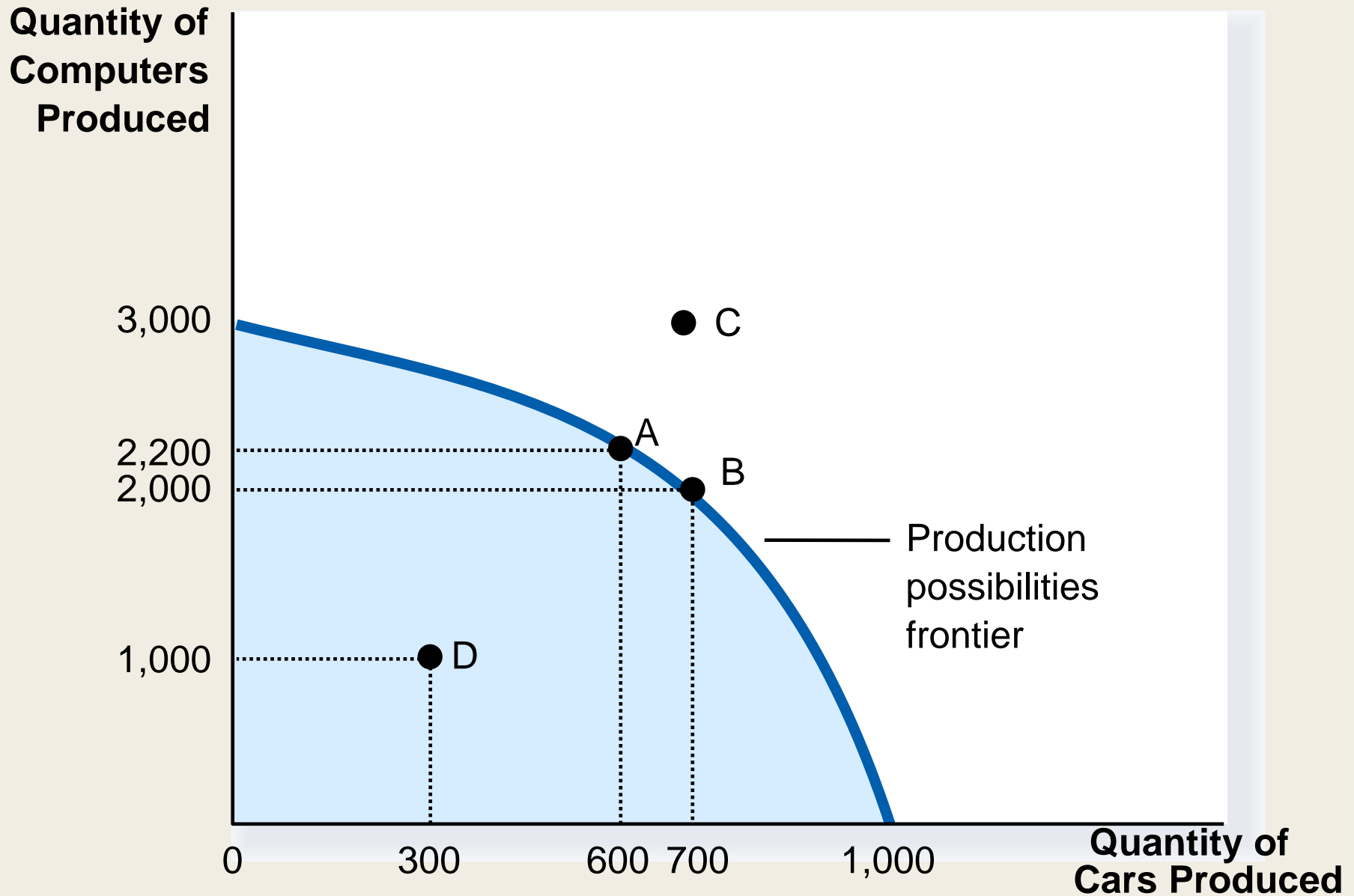
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## Thinking Like an Economist

# Our Second Model: The Production Possibilities Frontier

- The *production possibilities frontier* is a graph that shows the combinations of output that the economy can possibly produce given the available factors of production and the available production technology.

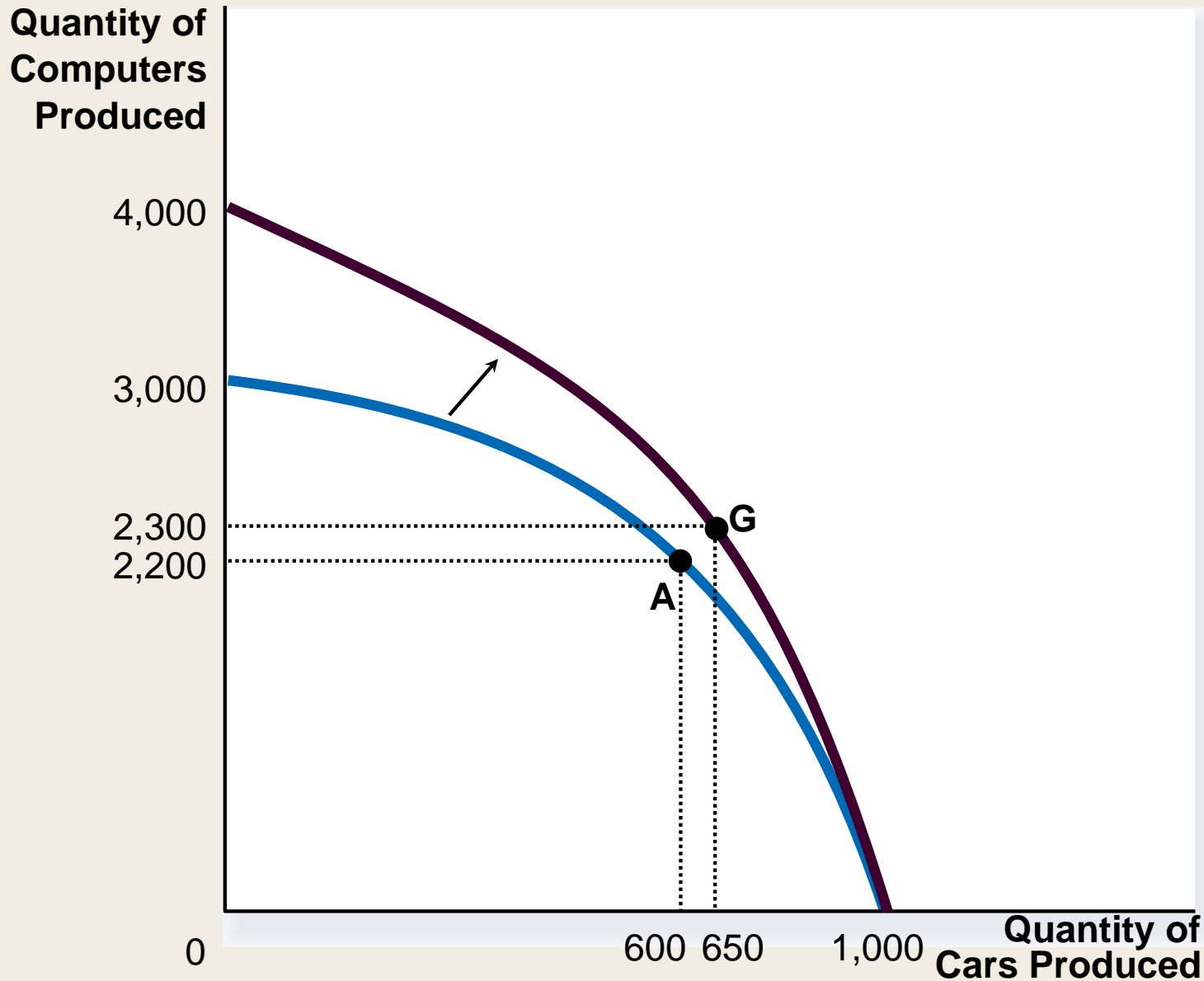
## Figure 2 The Production Possibilities Frontier



# Our Second Model: The Production Possibilities Frontier

- Concepts illustrated by the production possibilities frontier
  - Efficiency
  - Trade-offs
  - Opportunity cost
  - Economic growth

# Figure 3 A Shift in the Production Possibilities Frontier



# Microeconomics and Macroeconomics

- *Microeconomics* focuses on the individual parts of the economy.
  - How households and firms make decisions and how they interact in specific markets
- *Macroeconomics* looks at the economy as a whole.
  - Economy-wide phenomena, including inflation, unemployment, and economic growth



# THE ECONOMIST AS POLICY ADVISOR

- When economists are trying to explain the world, they are scientists.
- When economists are trying to change the world, they are policy advisors.

# Positive versus Normative Analysis

- *Positive statements* are statements that attempt to describe the world as it is.
  - Called descriptive analysis
- *Normative statements* are statements about how the world should be.
  - Called prescriptive analysis



# Positive Versus Normative Analysis

• Are the following positive or normative statements?

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- An increase in the minimum wage will cause a decrease in employment among the least-skilled.

- **POSITIVE**

- Higher federal budget deficits will cause interest rates to increase.

- **POSITIVE**

?

?

# Positive Versus Normative Analysis

- Are the following positive or normative statements?



- The income gains from a higher minimum wage are worth more than any slight reductions in employment.



- **NORMATIVE**

- State governments should be allowed to collect from tobacco companies the costs of treating smoking-related illnesses among the poor.

- **NORMATIVE**





# WHY ECONOMISTS DISAGREE

- They may disagree about the validity of alternative positive theories about how the world works.
- They may have different values and, therefore, different normative views about what policy should try to accomplish.

# Summary

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- Economists try to address their subjects with a scientist's objectivity.
  - They make appropriate assumptions and build simplified models in order to understand the world around them.
  - Two simple economic models are the circular-flow diagram and the production possibilities frontier.

# Summary

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- Economics is divided into two subfields:
  - Microeconomics is the study of decision-making by households and firms in the marketplace.
  - Macroeconomics is the study of the forces and trends that affect the economy as a whole.

# Summary

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- A positive statement is an assertion about how the world is.
- A normative statement is an assertion about how the world ought to be.
- When economists make normative statements, they are acting more as policy advisors than scientists.

# Summary

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- Economists who advise policymakers offer conflicting advice either because of differences in scientific judgments or because of differences in values.
- At other times, economists are united in the advice they offer, but policymakers may choose to ignore it.