

Chapter 2

Thinking Like an Economist

Presentation outline

- Distinguish between Microeconomics and Macroeconomics
- Learn the difference between positive and normative statements
- Examine the role of economists in making policy
- Consider why economists sometimes disagree with one another

Introduction

- Every subject has its own language, and economics is no exception
- **Story** behind the gravitation theory is everywhere

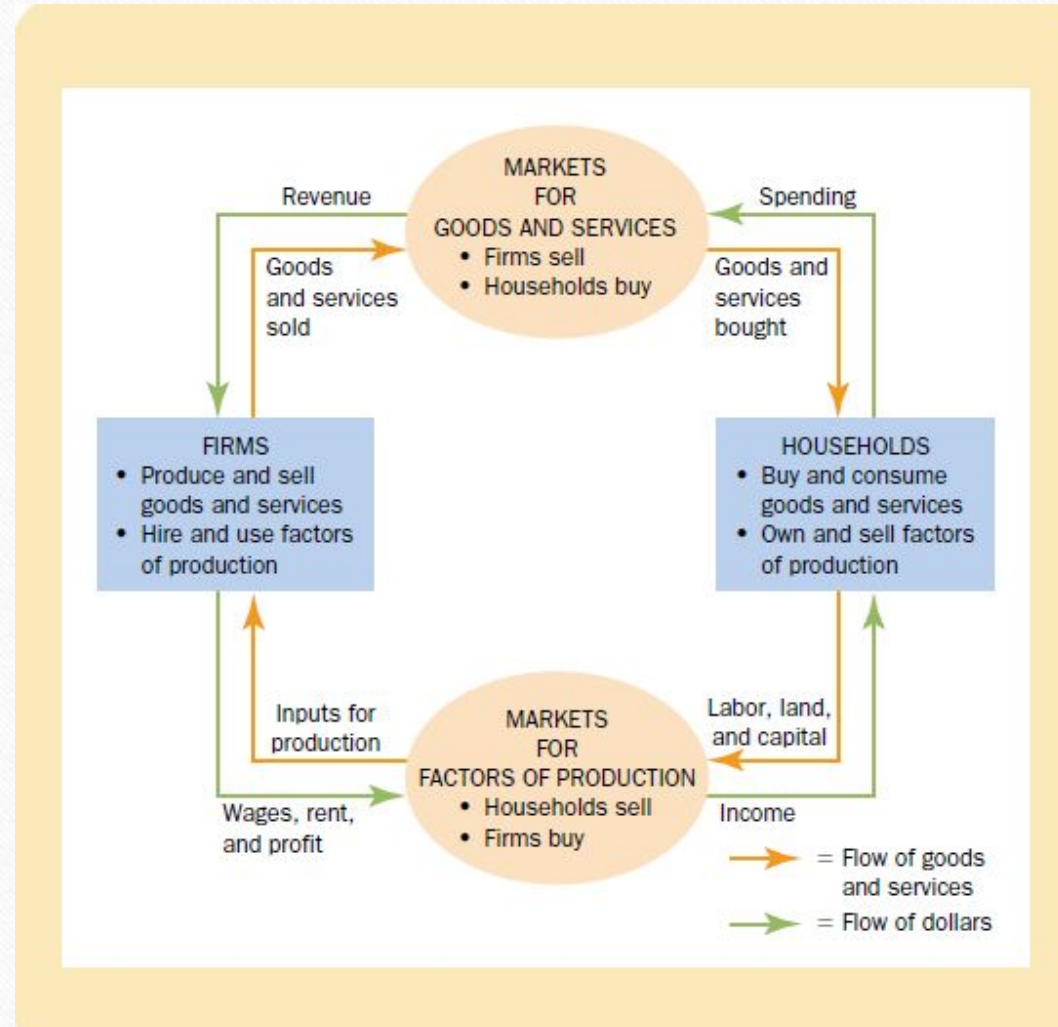
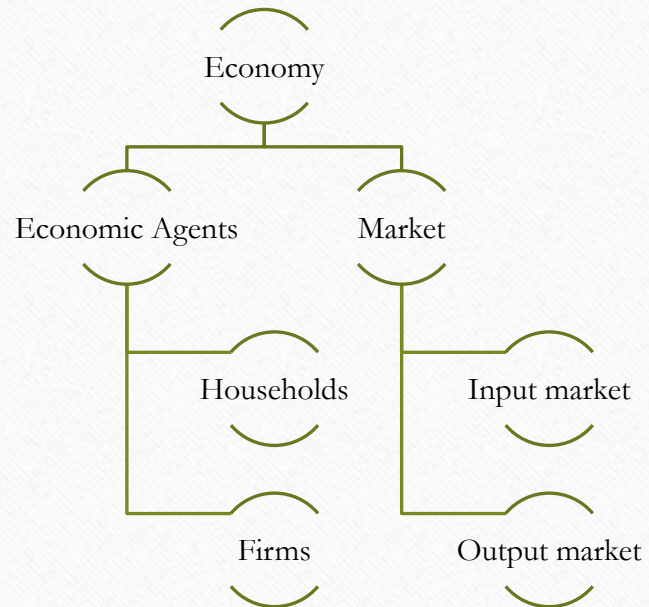


"I'm a social scientist, Michael. That means I can't explain electricity or anything like that, but if you ever want to know about people I'm your man."

Assumptions and models

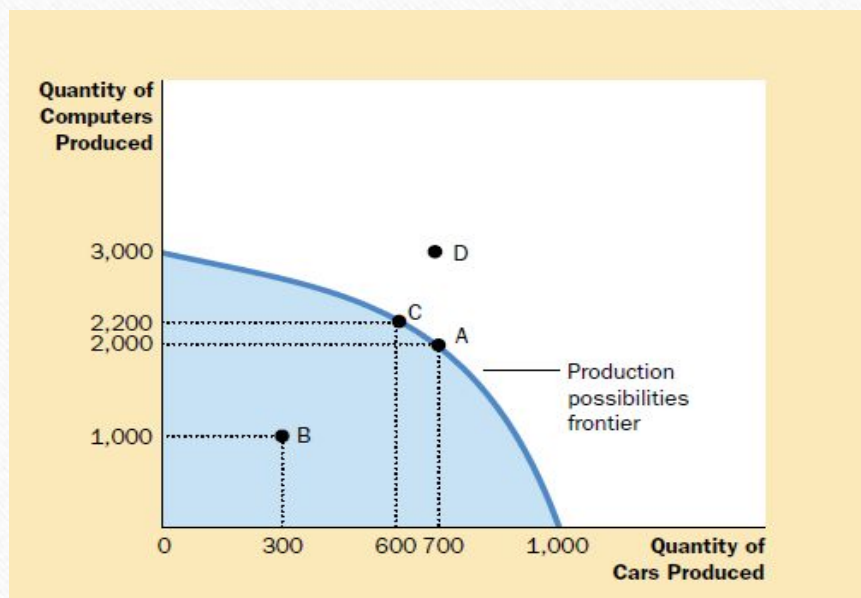
- Assumptions are made to construct a model in a easier way; e.g. trade, utility maximization etc.
- What kind of assumptions?-anything; e.g. prices are sticky in short-run; DID
- Any model is built to analyze the real world phenomena

Model 1: Circular flow of income

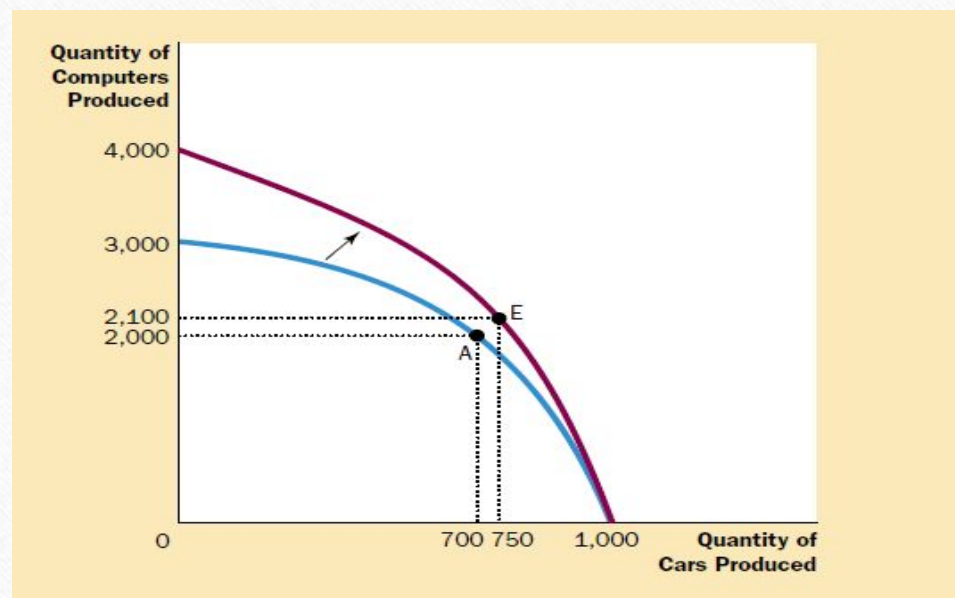


Model 2: Production Possibility Frontier (PPF)

PPF



Shift in PPF



Microeconomics and Macroeconomics

- Microeconomics: the study of households and firms
 - **Example:** the impact of foreign competition on the U.S. auto industry, or the effects of compulsory school attendance on workers' earnings
- Macroeconomics: the study of economy-wide phenomena
 - **Example:** the effects of borrowing by the federal government, or the changes over time in the economy's rate of unemployment

Positive vs. Normative

- Positive: Describes the world as it is (cause and effect)
 - **Example:** Pollution is affecting the natural resources
- Normative: Argues what should be done (ideal)
 - **Example:** Govt. should levy tax on pollution

Disagreement

- When the U.S President Harry Truman has asked his economists for advice, they always answered, “On the one hand, On the other hand,”
- Economists often disagree while prescribing policies
 - Keynes vs. Classical Economists
 - Neo-classics vs. Ecological Economists
 - Pigou vs. Coase

Why economists disagree?

- “If all economists were laid end to end, they would not reach a conclusion.”-George Bernard Shaw
- “If the game Trivial Pursuit were designed for economists, it would have 100 questions and 3,000 answers”-Ronald Reagan
- Reasons for disagreement
 - Disagreement on effectiveness of different positive theories
 - The normative goals may vary across economists

Cont...

- Differences in scientific judgments
 - Whether to put a tax on savings?
- Differences in values
 - Peter and Paul example
- Perception vs. reality
 - NAFTA