

Economic Models

- Economics relies on the *scientific method*
 - first develop models (ie, theories) to help explain how the real world operates
 - then collect and analyze data to test the validity of those models
- Economic models
 - are simplifications of reality
 - should be as simple as possible while still capturing the essence of the phenomena being examined
 - allow economists to focus on essential features of the phenomena being examined

Two Main Branches Of Economics

- Economics is divided into two main branches
 - microeconomics
 - macroeconomics

Microeconomics

- Microeconomics
 - deals with product, labour, and capital markets
 - focuses households and firms make decisions and how they interact in specific markets
 - takes a “bottom up” view of the economy

Macroeconomics

- Macroeconomics
 - deals with the behaviour of the economy as a whole
 - focuses on economy-wide phenomena such a rates of unemployment, inflation and economic growth
 - examines what is happening on average
 - takes a “top down” view of the economy

Positive and Normative Economics

- *Positive economics* is concerned with
 - describing how the economy functions
 - predicting what will happen if some policy is changed (eg, if taxes are increased)
- Positive economics
 - focuses on “what if” questions
 - tries to be value free
 - involves descriptive analysis
- Positive statements are statements about how the world works
- *Normative economics* is concerned with
 - weighing costs and benefits of alternative policies
 - judging the desirability of various courses of action (policies)
- Normative economics
 - focuses on “what should” questions
 - is value laden
 - involves prescriptive analysis
- Normative statements are statements about how the world should be

Question: Are the following statements positive or normative statements?

- Increasing government spending would shorten the length of the recession
- The government should not spend taxpayers' money to support firms in the auto sector
- Raising interest rates encourages people to save more
- People should be encouraged to save more
- The majority of the population would prefer a policy that reduced unemployment to one that reduced inflation
- Unemployment is a more important social problem than inflation