

Business Administration 301

(Mark Stegeman)

Economics: the big picture

1. Is economics a science?
2. Imprecision affects the practice of economics
3. Positive and normative economics
4. Economists' fundamental assumptions about behavior
5. Opportunity cost

Definition of a Science

- A hypothesis or theory that makes testable predictions (if X then Y).
- A systematic program of testing those predictions against received or experimental data, and revising the theory accordingly.

Economics is an Imprecise Science

- The system is complicated.
- The system changes.
- It is hard to do experiments.

Because the economic world is too complex to understand, we seek partial understanding through simple models and assumptions.

Imprecision Affects Practice

Data often do not indicate clearly which model or theory is best.

- ⇒ Intuition about human behavior and institutions is useful for helping to choose between models, but it should never take precedence over data.
- ⇒ Political biases can affect economists' choice of models and interpretation of data.
- ⇒ Debates can go on forever.

Positive and Normative Economics

Positive economics refers to the scientific enterprise, which is dedicated to making *predictions*.

Normative economics makes *recommendations*, to individuals or firms or governments. This almost always requires value judgments.

Economists' Fundamental Assumptions About Behavior

People are:

- Selfish
- Rational

Typical objectives:

Wealth
Power
Knowledge
Health / longevity
Fame / social esteem
Quality of mate / sex
Quality of physical environment
Emotional attachment (love)
Competition / winning
Leisure / comfort / quietude
Internal sense of achievement

So are firms.

Opportunity Cost

Opportunity cost is, broadly: the opportunity one sacrifices by investing resources somewhere else.

Much of economics concerns tradeoffs.

Production Possibilities Curve

