# Thinking Like an Economist

## Chapter 2

Economics trains you to . . .

- Be mindful about the choices that you make.
- Evaluate the cost of individual and social choices.
- Examine and understand how certain events and issues are related.
- But there is the issue of terminology, some math, and **GRAPHICS, GRAPHS AND SOME MORE GRAPHS!**

## Economic Models

- Economists use models to simplify reality in order to improve our understanding of the world.
- As simplifications of reality, models need assumptions.
  - A Model of Bird Flight
  - Models start small and then grow in increasing complexity.
  - Play Roles by Maurice Ravel

## Graphing Data

- A graph reveals a causal relationship between two variables.
  - The vertical line is the y-axis.
  - The horizontal line is the x-axis.
  - Independent variable
  - What do we do when a positive and a positive relationship between variables?

## The Economist as a Scientist

The economic way of thinking . . .

- Involves thinking analytically and objectively.
- Makes use of the scientific method.
  - Develops the use of abstract models to focus the discussion on a main idea or theme in the complexity of the real world.
  - To apply the scientific method in economics, assumptions are used to make the world easier to understand.
  - Constant Factors: Assumptions All else equal.
  - Rule Two: Never purchase something at a store.

## Two Simple Rules for Movements vs. Shifts

- **Rule One**
  - When an independent variable changes and that variable does not appear on the graph, the curve on the graph will shift.

- **Rule Two**
  - When an independent variable changes and does appear on the graph, a movement along the existing curve will occur. The curve will not shift.
Graphing Data

- Economists use three types of graphs to reveal relationships between variables. They are:
  - Time-series graphs
  - Cross-section graphs
  - Scatter diagrams

Two of the Most Basic Economic Models Are

- The Circular Flow Diagram
- The Production Possibilities Frontier

Journal Assignment - Circular Flow Diagram

- Draw a circular flow diagram.
- Identify the parts of the model that correspond to the flow of goods and services and the flow of dollars for each of the following activities:
  - Sam pays $1.00 for a quart of milk.
  - Sam gets a quart of milk.
  - Sally earns $4.25 per hour working at a fast food restaurant.
  - Sally works at the restaurant.

The Production Possibilities Frontier

- Shows the various combinations of two goods that can be produced by one firm.
- Assumes two goods
- Assumes fixed technology and fixed factors of production.
The Production Possibilities Frontier

<table>
<thead>
<tr>
<th>Quantity of Computers Produced</th>
<th>Quantity of Cars Produced</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,000</td>
<td>3,000</td>
</tr>
<tr>
<td>2,000</td>
<td>2,200</td>
</tr>
<tr>
<td>3,000</td>
<td>2,000</td>
</tr>
<tr>
<td>4,000</td>
<td>1,800</td>
</tr>
</tbody>
</table>

An outward shift in the production possibilities frontier can be caused by:
- Increase in technology to produce computers.

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.
  - How the markets, as a whole, interact at the national level.

The Essence of Microeconomics—Buyers and Sellers

- Efficiency
- Tradeoffs
- Opportunity Cost
- Economic Growth

The Many Facets of Macroeconomics

- Externalities
- Public Goods
- Market Failure
- Global Economy
- Monetary Policy
- Fiscal Policy
- Economic Growth
- Income Distribution
- Inflation
- Unemployment
- International Trade

Two Roles of Economists

- When they are trying to explain the world, they are **scientists**.
- When they are trying to change the world, they are **policymakers**.

Positive versus Normative Analysis

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

Why Economists Agree and Disagree

- We agree on the methodology, but not on the underlying assumptions underlying incentives and behavior.
- Example: No Child Left Behind and Test Scores.