

Chapter 2 Thinking like an Economist

- What are models? How do economists use them?
- What are the elements of the Circular-Flow Diagram? What concepts does the diagram illustrate?
- How is the Production Possibilities Frontier related to opportunity cost? What other concepts does it illustrate?
- What is the difference between microeconomics and macroeconomics? Between positive and normative?

Economists play two roles: Scientists and Policy advisors

Model:

Model 1: Circular Flow Diagram

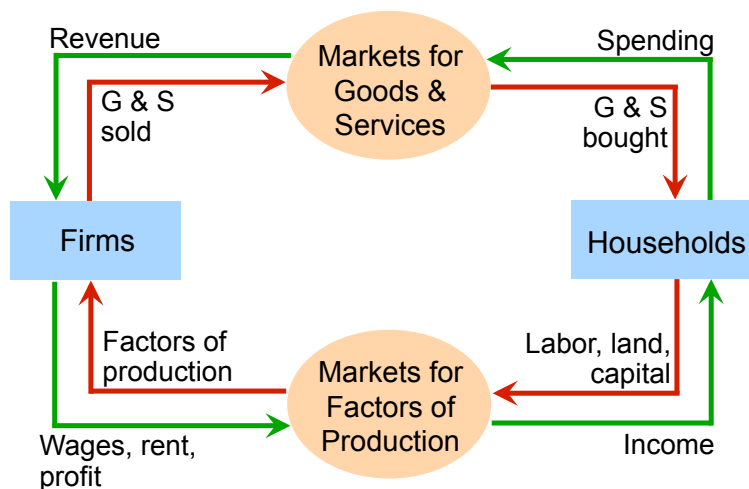
Circular Flow Diagram:

Two types of “actors”:

Two markets:

Factors of production:

FIGURE 1: The Circular-Flow Diagram



THINKING LIKE AN ECONOMIST

11

- Outer loop reps flows of income/payments between hh & firms
- Inner loop reps flows of inputs and outputs between hh & firms

Model 2: Production Possibilities Frontier (Tradeoffs)

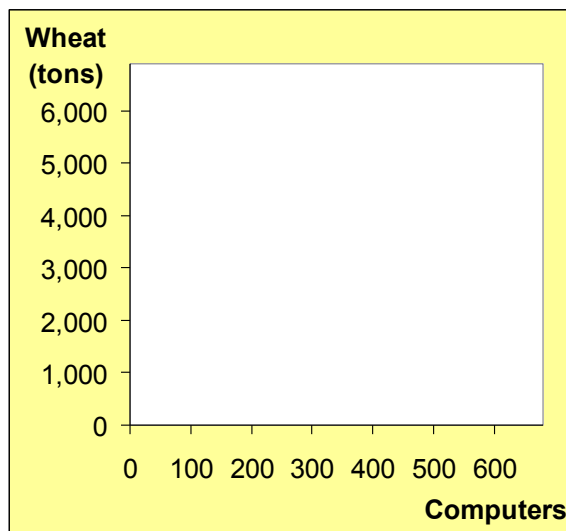
PPF:

Example: Produce 2 goods: computers & wheat, 50,000 labor hours per month available

PPF Example

- Producing one computer requires 100 hours labor.
- Producing one ton of wheat requires 10 hours labor.

	Employment of labor hours		Production	
	Computers	Wheat	Computers	Wheat
A	50,000	0	500	0
B	40,000	10,000		
C	25,000	25,000		
D	10,000	40,000		
E	0	50,000	0	5,000



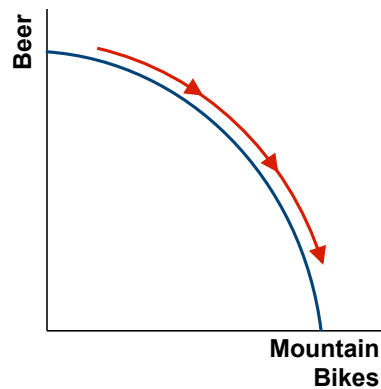
Economic Growth and the PPF: change in technology, change in resources.

The shape of PPF: straight line, or bow-shaped

Why the PPF Might Be Bow-Shaped

As the economy shifts resources from beer to mountain bikes:

- PPF becomes steeper
- opp. cost of mountain bikes increases



THINKING LIKE AN ECONOMIST

24

microeconomics:

macroeconomics:

positive statements (descriptive, based on fact, Was, is, will):

normative statements (value judgment, prescriptive, Should, ought):

Suggested Problems: Problems and Applications- 4, 5, 6