

The Scope and Method of Economics

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Chapter Outline

Why Study Economics?

- To Learn a Way of Thinking
- To Understand Society
- To Understand Global Affairs
- To Be an Informed Voter

The Scope of Economics

- Microeconomics and
Macroeconomics
- The Diverse Fields of Economics

The Method of Economics

- Theories and Models
- Economic Policy

An Invitation

- Appendix: How to Read
and Understand Graphs

THE SCOPE AND METHOD OF ECONOMICS

economics The study of how individuals and societies choose to use the scarce resources that nature and previous generations have provided.

Economics is the study of how individuals and societies choose to use the scarce resources that nature and previous generations have provided. The key word in this definition is choose. Economics is a behavioral, or social, science. In large measure it is the study of how people make choices. The choices that people make, when added up, translate into societal choices.

WHY STUDY ECONOMICS?

There are four main reasons to study economics:

- to learn a way of thinking,
- to understand society,
- to understand global affairs, and
- to be an informed voter.

WHY STUDY ECONOMICS?

TO LEARN A WAY OF THINKING

Three fundamental concepts:

Opportunity cost

Marginalism, and

Efficient markets

WHY STUDY ECONOMICS?

Opportunity Cost

opportunity cost The best alternative that we forgo, or give up, when we make a choice or a decision.

scarce Limited.

WHY STUDY ECONOMICS?

Efficient Markets—No Free Lunch

efficient market A market in which profit opportunities are eliminated almost instantaneously.

The study of economics teaches us a way of thinking and helps us make decisions.

WHY STUDY ECONOMICS?

TO UNDERSTAND SOCIETY

Industrial Revolution The period in England during the late eighteenth and early nineteenth centuries in which new manufacturing technologies and improved transportation gave rise to the modern factory system and a massive movement of the population from the countryside to the cities.

The study of economics is an essential part of the study of society.

WHY STUDY ECONOMICS?

TO UNDERSTAND GLOBAL AFFAIRS



The events of September 11, 2001, dealt a blow to the tourism industry and left airlines in deep financial trouble.

An understanding of economics is essential to an understanding of global affairs.

WHY STUDY ECONOMICS?

TO BE AN INFORMED VOTER

A knowledge of economics is essential to be an informed voter.

When we participate in the political process, we are voting on issues that require a basic understanding of economics.

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MICROECONOMICS AND MACROECONOMICS

microeconomics The branch of economics that examines the functioning of individual industries and the behavior of individual decision-making units—that is, business firms and households.

macroeconomics The branch of economics that examines the economic behavior of aggregates—income, employment, output, and so on—on a national scale.

Microeconomics looks at the individual unit—the household, the firm, the industry. It sees and examines the “trees.” Macroeconomics looks at the whole, the aggregate. It sees and analyzes the “forest.”

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THE DIVERSE FIELDS OF ECONOMICS

TABLE 1.1 Examples of Microeconomic and Macroeconomic Concerns

DIVISION OF ECONOMICS	PRODUCTION	PRICES	INCOME	EMPLOYMENT
Microeconomics	<i>Production/output in individual industries and businesses</i>	<i>Price of individual goods and services</i>	<i>Distribution of income and wealth</i>	<i>Employment by individual businesses and industries</i>
	How much steel How much office space How many cars	Price of medical care Price of gasoline Food prices Apartment rents	Wages in the auto industry Minimum wage Executive salaries Poverty	Jobs in the steel industry Number of employees in a firm Number of accountants
Macroeconomics	<i>National production/output</i>	<i>Aggregate price level</i>	<i>National income</i>	<i>Employment and unemployment in the economy</i>
	Total industrial output Gross domestic product Growth of output	Consumer prices Producer prices Rate of inflation	Total wages and salaries Total corporate profits	Total number of jobs Unemployment rate

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positive economics An approach to economics that seeks to understand behavior and the operation of systems without making judgments. It describes what exists and how it works.

normative economics An approach to economics that analyzes outcomes of economic behavior, evaluates them as good or bad, and may prescribe courses of action. Also called policy economics.

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Descriptive Economics and Economic Theory

descriptive economics The compilation of data that describe phenomena and facts.

economic theory A statement or set of related statements about cause and effect, action and reaction.

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THEORIES AND MODELS

model A formal statement of a theory, usually a mathematical statement of a presumed relationship between two or more variables.

variable A measure that can change from time to time or from observation to observation.

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All Else Equal: *Ceteris Paribus*

***ceteris paribus*, or all else equal** A device used to analyze the relationship between two variables while the values of other variables are held unchanged.

Using the device of *ceteris paribus* is one part of the process of abstraction. In formulating economic theory, the concept helps us simplify reality to focus on the relationships that interest us.

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Expressing Models in Words, Graphs, and Equations

The most common method of expressing the quantitative relationship between two variables is graphing that relationship on a two-dimensional plane.

THE METHOD OF ECONOMICS

Testing Theories and Models: Empirical Economics

empirical economics The collection and use of data to test economic theories.

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ECONOMIC POLICY

Criteria for judging economic outcomes:

1. Efficiency
2. Equity
3. Growth
4. Stability

THE METHOD OF ECONOMICS

Efficiency

efficiency In economics, allocative efficiency. An efficient economy is one that produces what people want at the least possible cost.

Equity

equity Fairness.

THE METHOD OF ECONOMICS

Growth

economic growth An increase in the total output of an economy.

Stability

stability A condition in which national output is growing steadily, with low inflation and full employment of resources.

AN INVITATION

As you proceed, it is important that you keep track of what you have learned in earlier chapters. This book has a plan; it proceeds step by step, each section building on the last. It would be a good idea to read each chapter's table of contents and scan each chapter before you read it to be sure you understand where it fits in the big picture.

Review Terms and Concepts

ceteris paribus

descriptive economics

economic growth

economic theory

economics

efficiency

efficient market

empirical economics

equity

fallacy of composition

Industrial Revolution

macroeconomics

marginalism

microeconomics

model

normative economics

Ockham's razor

opportunity cost

positive economics

post hoc, ergo propter hoc

scarce

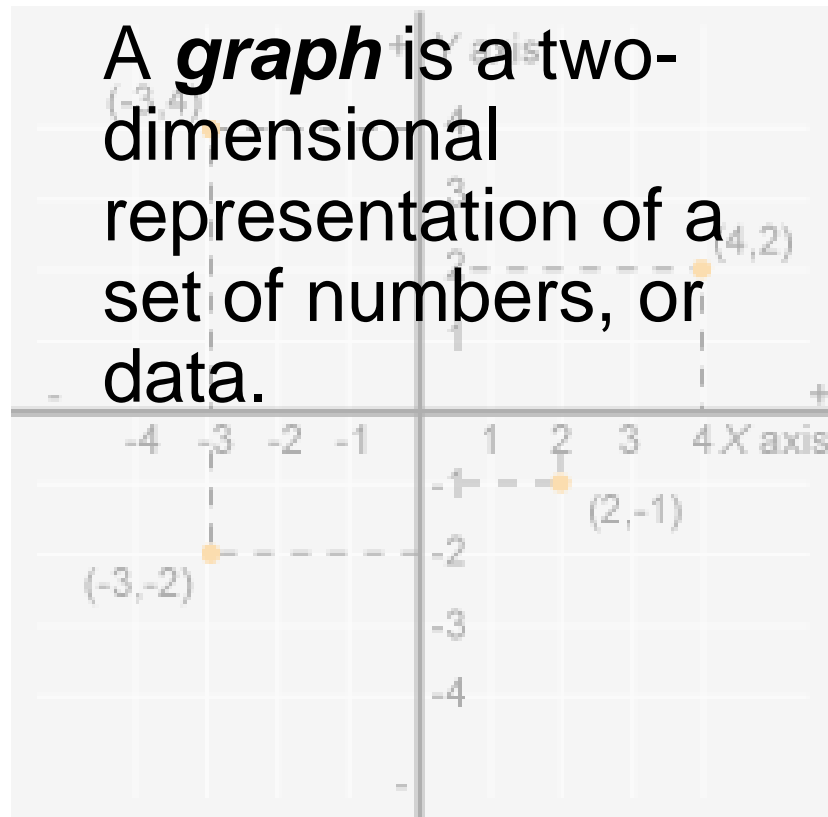
stability

sunk costs

variable

HOW TO READ AND UNDERSTAND GRAPHS

A **graph** is a two-dimensional representation of a set of numbers, or data.

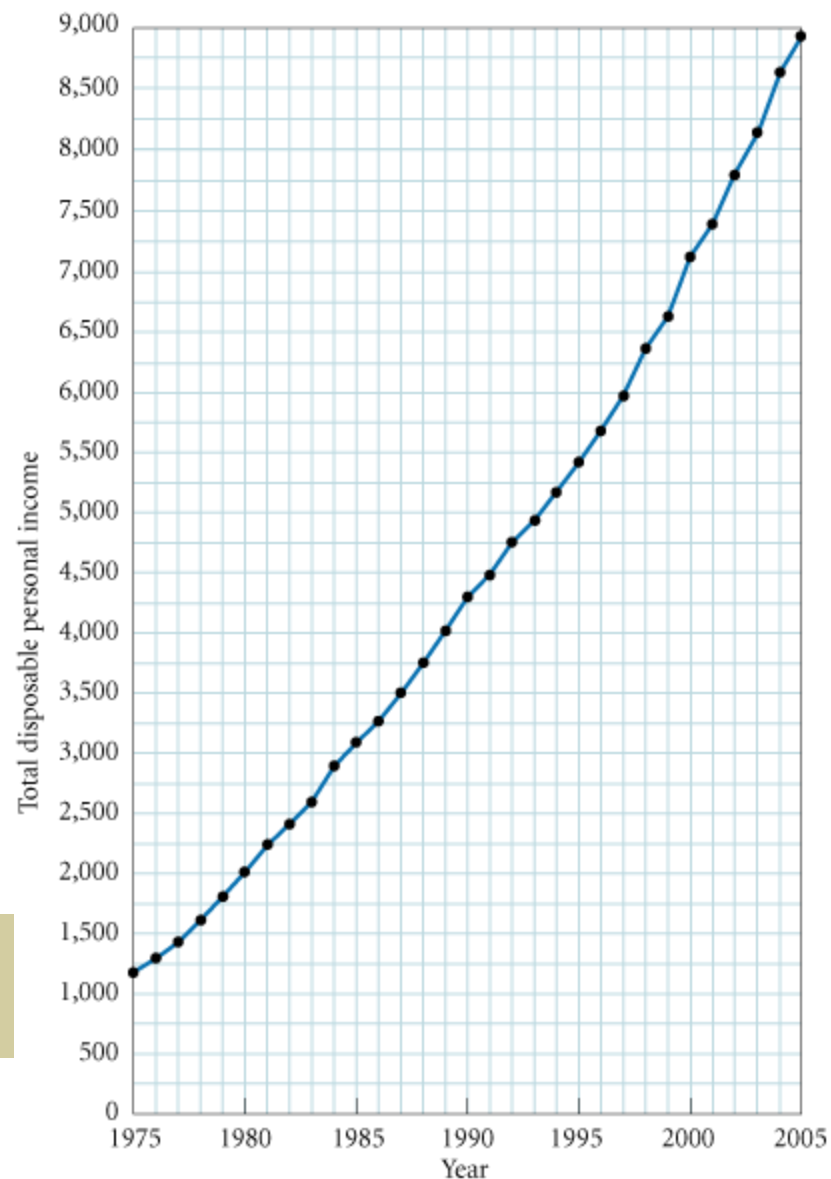


Appendix

TIME SERIES GRAPH

A *time series graph* shows how a single variable changes over time.

FIGURE 1A.1 Total Disposable Personal Income in the United States: 1975–2005 (in billions of dollars)



Appendix

GRAPHING TWO VARIABLES ON A CARTESIAN COORDINATE SYSTEM

The **Cartesian coordinate system** is the most common method of graphing two variables. This system is constructed by simply drawing two perpendicular lines: a horizontal line, or **X-axis**, and a vertical line, or **Y-axis**. The axes contain measurement scales that intersect at 0 (zero). This point is called the **origin**.

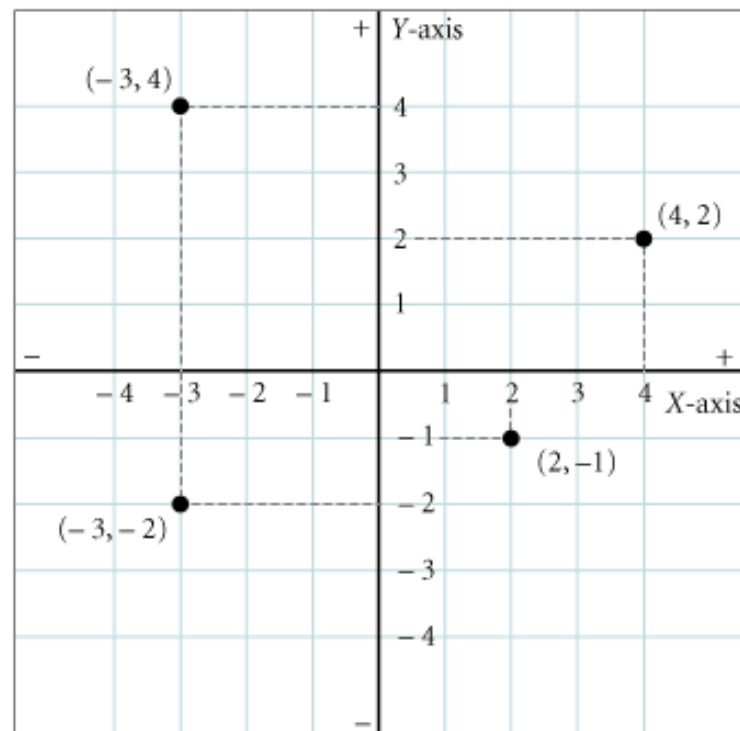


FIGURE 1A.2 A Cartesian Coordinate System

Appendix

PLOTTING INCOME AND CONSUMPTION DATA FOR HOUSEHOLDS

TABLE 1A.1 Total Disposable Personal Income in the United States, 1975–2005 (in billions of dollars)

YEAR	TOTAL DISPOSABLE PERSONAL INCOME	YEAR	TOTAL DISPOSABLE PERSONAL INCOME
1975	1,181.4	1989	4,016.3
1976	1,299.9	1990	4,293.6
1977	1,436.0	1991	4,474.8
1978	1,614.8	1992	4,754.6
1979	1,808.2	1993	4,935.3
1980	2,019.8	1994	5,165.4
1981	2,247.9	1995	5,422.6
1982	2,406.8	1996	5,677.7
1983	2,586.0	1997	5,968.2
1984	2,887.6	1998	6,355.6
1985	3,086.5	1999	6,627.4
1986	3,262.5	2000	7,120.2
1987	3,459.5	2001	7,393.2
1988	3,752.4	2002	7,827.7
		2003	8,159.9
		2004	8,646.9
		2005	8,945.6

Appendix

TABLE 1A.2 Consumption Expenditures and Income, 2003

	AVERAGE INCOME BEFORE TAXES	AVERAGE CONSUMPTION EXPENDITURES
Bottom fifth	\$ 8,201	\$ 18,492
2nd fifth	21,478	26,729
3rd fifth	37,542	36,213
4th fifth	61,132	50,468
Top fifth	127,146	81,731

This line slopes upward, indicating that there seems to be a **positive relationship** between income and spending.

Points A and B, above the 45° line, show that consumption can be greater than income.

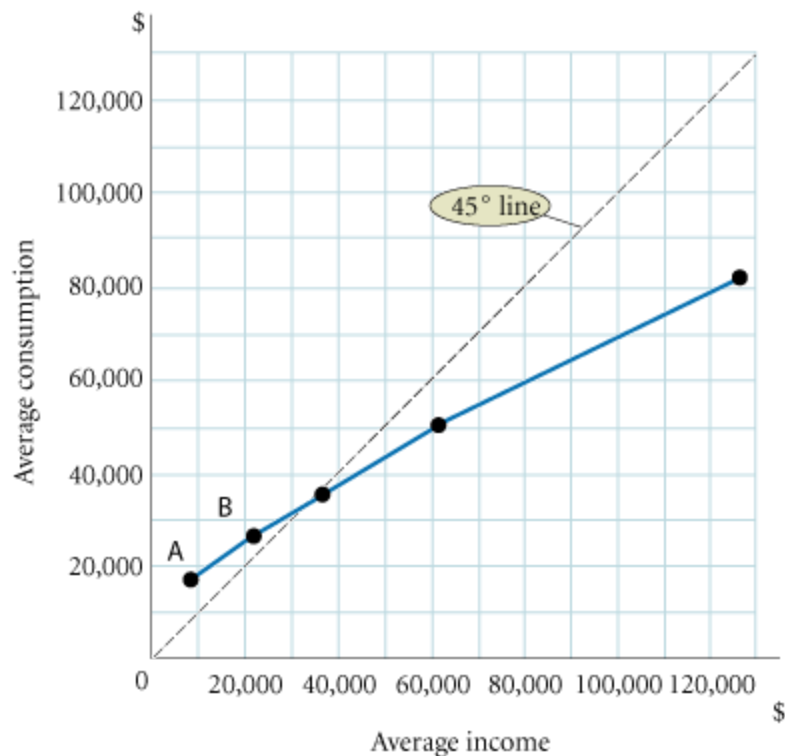
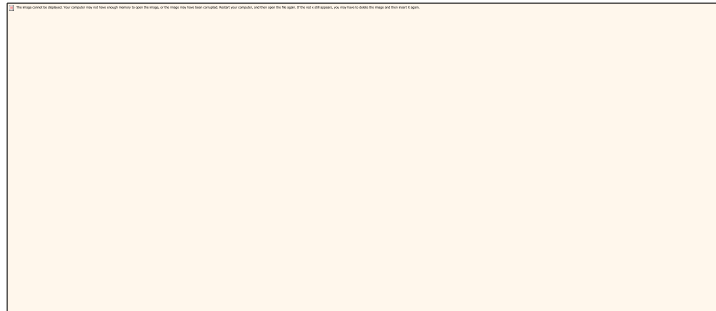


FIGURE 1A.3 Household Consumption and Income

Appendix

The **slope** of the line indicates whether the relationship between the variables is positive or negative.

The slope of the line is computed as follows:



Appendix

An **upward-sloping** line describes a **positive relationship** between X and Y.

A **downward-sloping** line describes a **negative relationship** between X and Y.

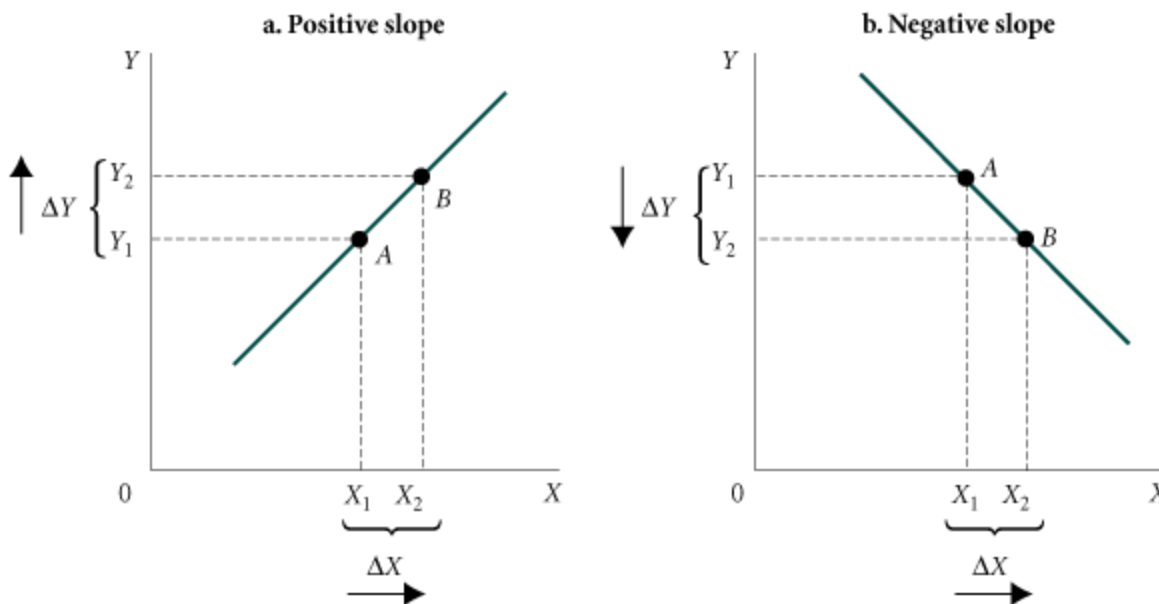


FIGURE 1A.4 A Curve with (a) Positive Slope and (b) Negative Slope

Appendix

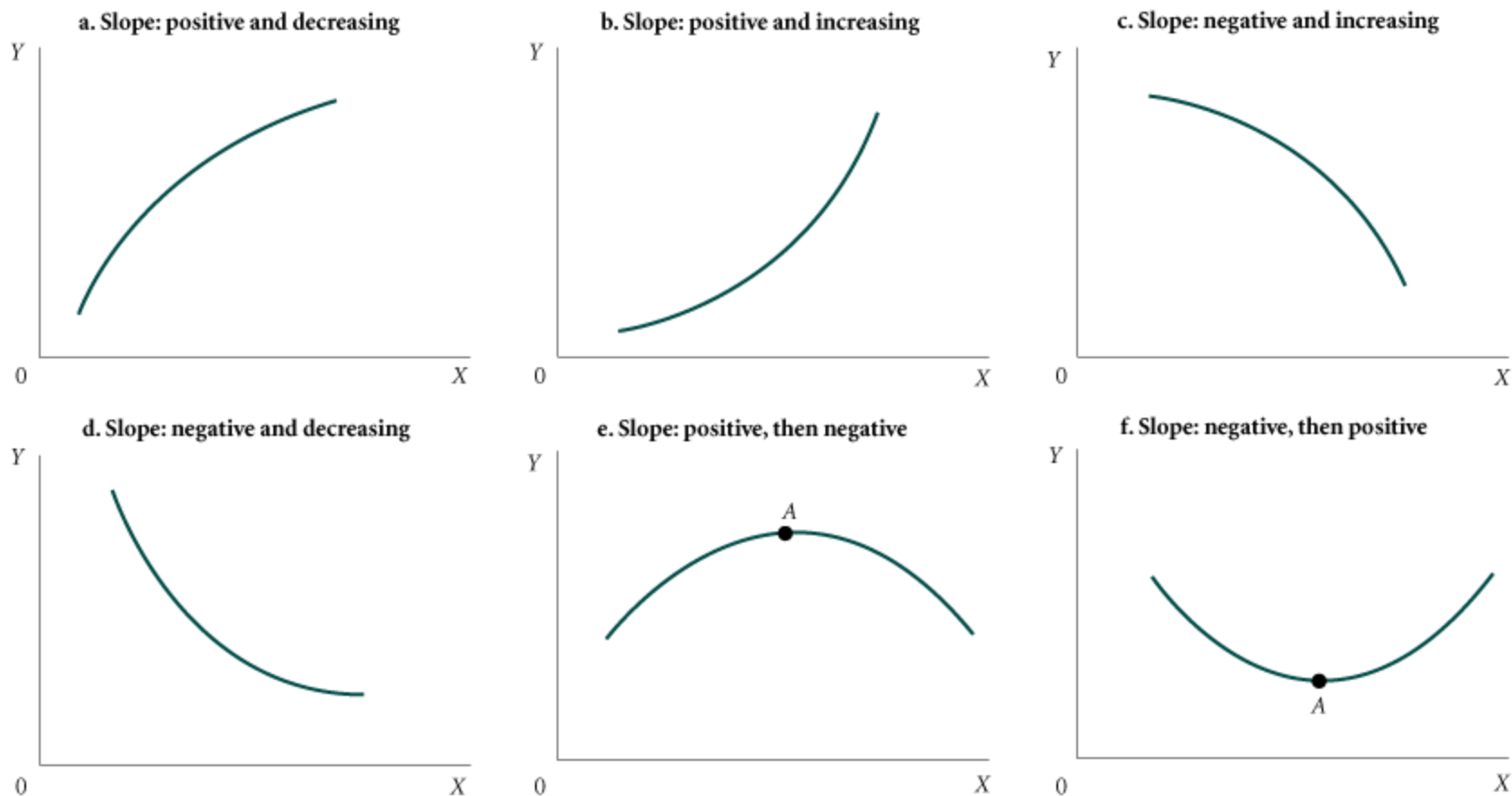


FIGURE 1A.5 Changing Slopes Along Curves

Appendix

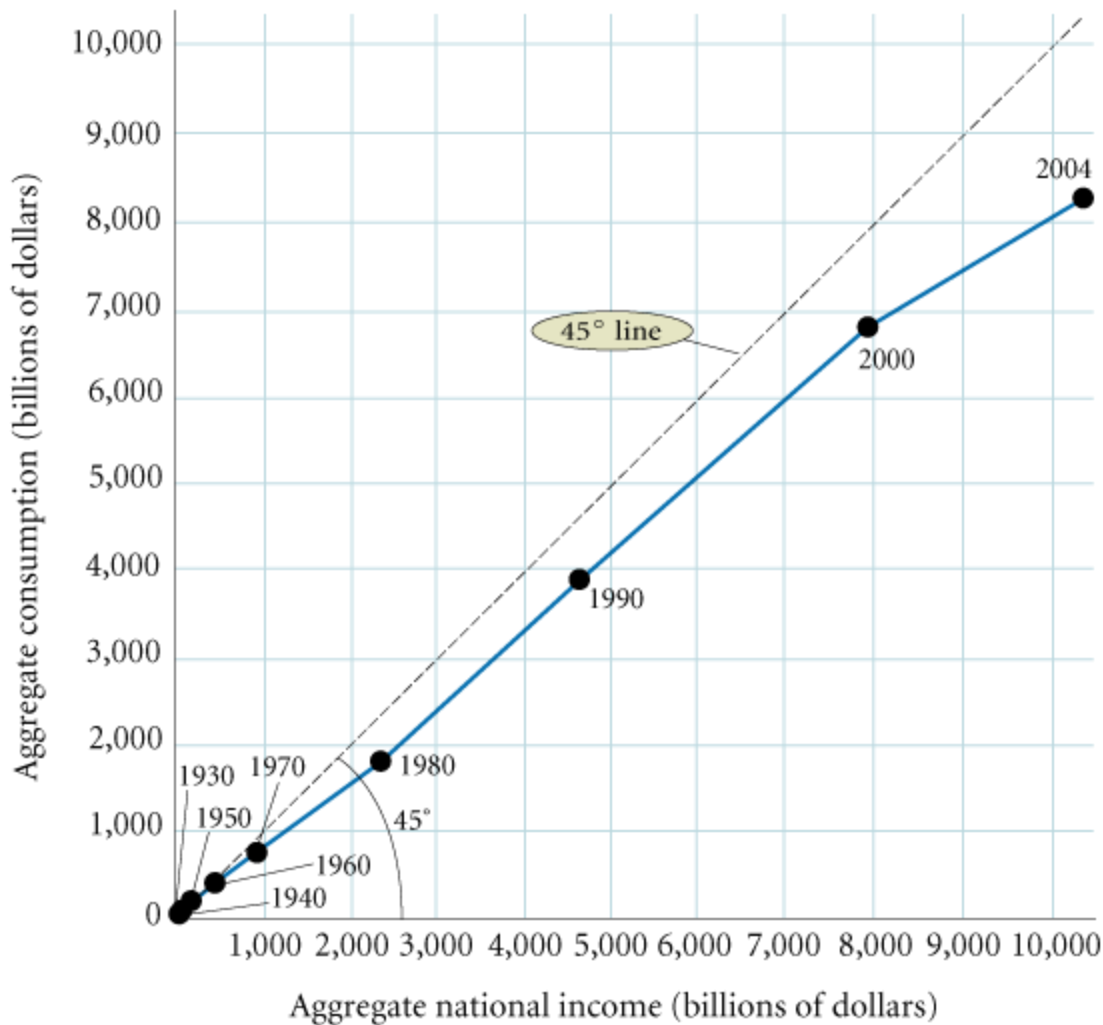


FIGURE 1A.6 National Income and Consumption