

# 116 How do economists work?

Some of the big ideas

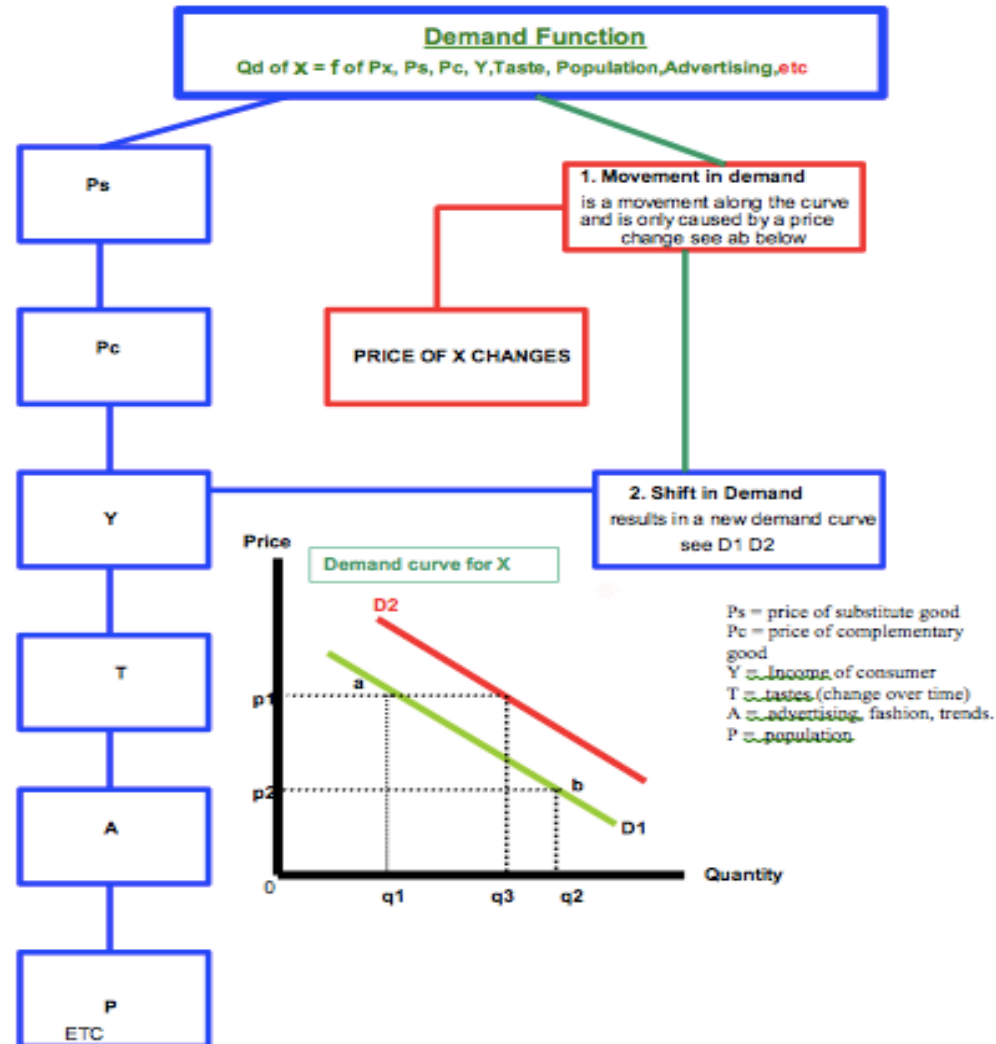
# How do Economists work?

Some of the big ideas:

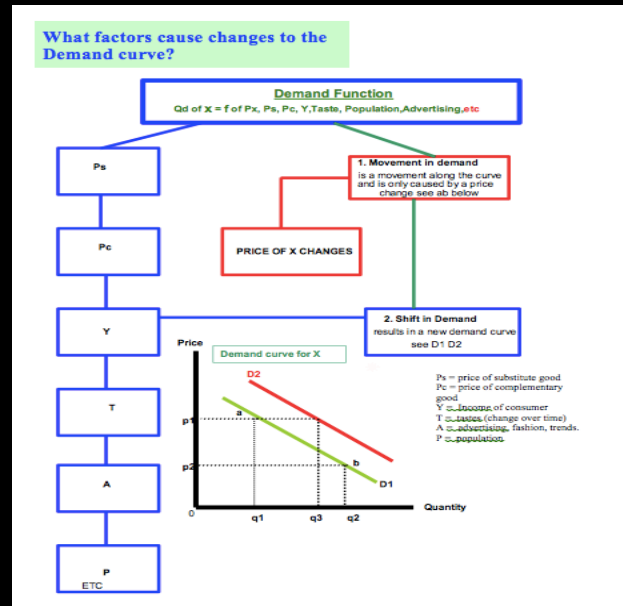
- positive vs normative
  - Logic
  - Hypotheses
- Ceteris paribus assumptions
- Empirical evidence (field research)
  - Theories
- Models ( PPC, Circular Flow, Business Cycle)
  - Refutation

# Ceteris paribus

What factors cause changes to the Demand curve?



# Ceteris paribus



Demand Example:  
increase consumer  
income and demand  
rises good X **but** keep all  
other variables affecting  
**Qd** fixed such as price  
of good X, price of  
substitute goods etc.  
Result is demand shifts  
from green to red.

Ceteris paribus is tactic used by economists to examine change in ONE variable holding all other variables constant. E.g. increase income (D1 shifts to D2) and hold all other variables constant (including price) then quantity on the X axis will change to q3 but in reality all variables will be affected and price on the Y axis will not remain unchanged. However, using 'ceteris paribus' then we can isolate the effect of a change in income on demand in a market.

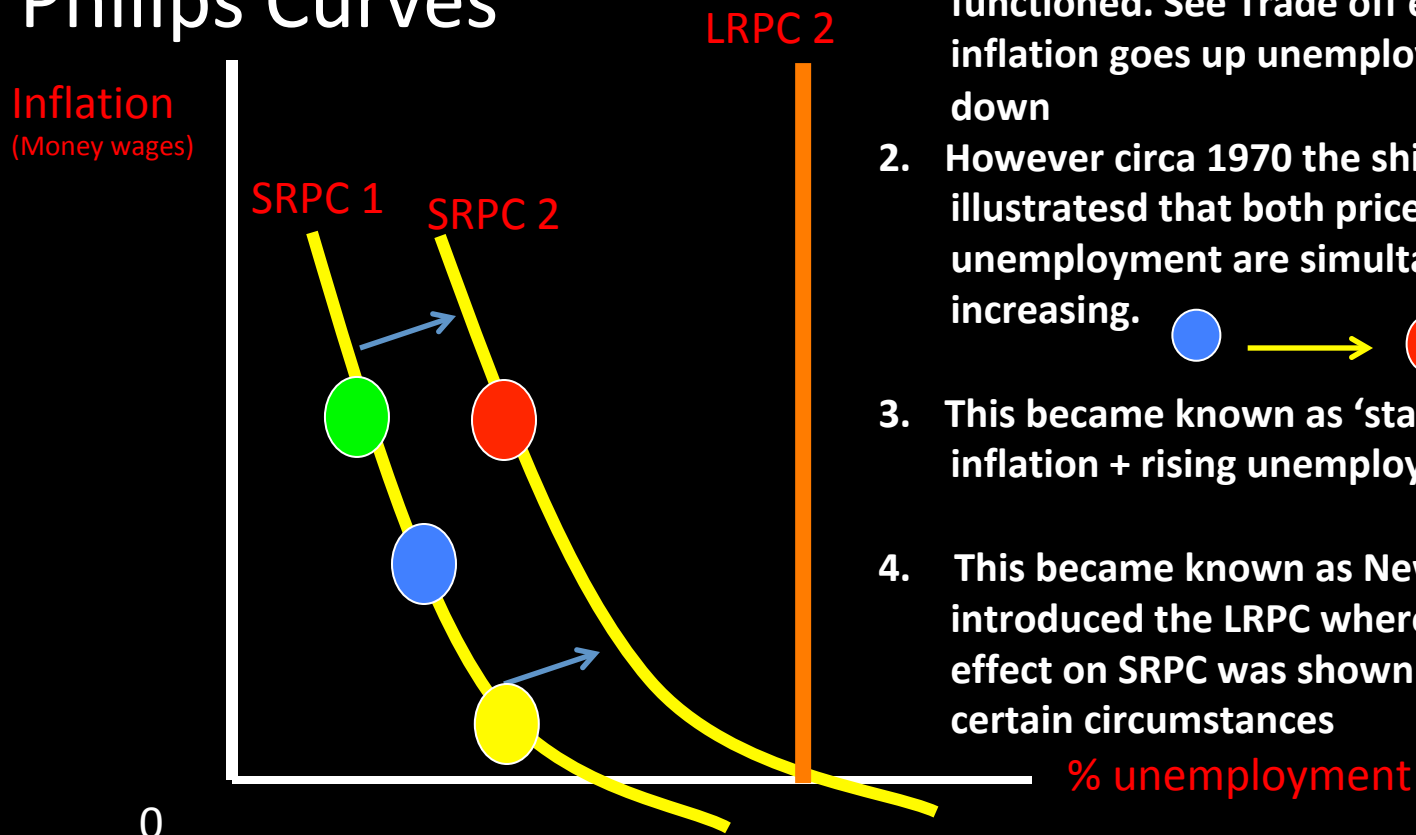
# Refutation


- A.W Philips research in the 1950's showed a special relationship between inflation and unemployment in a macro economy. This became known as the 'trade off' effect where unemployment and inflation moved in opposite directions
- The theory was refuted in the 1970's by Friedman and the Chicago school of economics.

# Refutation

## Long Run Philips(LRPC) curve replaces Short Run Philips (SRPC) curve:

### • Philips Curves



1. Philips Curve operated from 1950's to circa 1970's to explain how economy functioned. See Trade off effect on PC1: inflation goes up unemployment goes down
2. However circa 1970 the shift in the SRPC illustrated that both prices and unemployment are simultaneously increasing. 
3. This became known as 'stagflation': rising inflation + rising unemployment
4. This became known as New theory introduced the LRPC where trade off effect on SRPC was shown not to work in certain circumstances

# Positive vs Normative

- Economics is a positive science
- What is...was...or ~~will~~ **might** be!

# Normative economics

- What 'ought' to be. This is opinion based.
- **Equity** is a key issue here. More equity in an economic system requires higher taxes. Some stakeholders will not support this e.g. tax payer
- Universal health care: e.g. despite Obama care USA some 50 million do not enjoy free health care.



# economics

- Hypothesis
- Theory
- Empirical research
- Models : e.g. supply and demand model with a price mechanism designed explain how micro markets (and consumers) behave

# The market...where we are going to next!

