N. Gregory Mankiw & Mohamed H. Rashwan

Principles of

# Economics

Middle East Edition

# Chapter 2 - Thinking Like an Economist

## *In this chapter, look for the answers to these questions:*

- What is the difference between microeconomics and macroeconomics? Between positive and normative?
- What are economists' two roles? How do they differ?
- 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?

# Microeconomics and Macroeconomics

- **Microeconomics** is the study of how households and firms make decisions and how they interact in markets. افراد
- **Macroeconomics** is the study of economy-wide phenomena, including inflation, unemployment, and economic growth. دوله

  تضخم بطالة
- These two branches of economics are closely intertwined, yet distinct—they address different questions.

# 4 sectors of economy (society)

## قطاعات اقتصادية

- Individual (HH) افراد
- Firms شركات
- Government حكومة
- Foreign خارجي

# The Economist as Scientist

عالم اقتصاد

- Economists play two roles:
  1. Scientists: try to explain the world
  2. Policy advisors: try to improve it

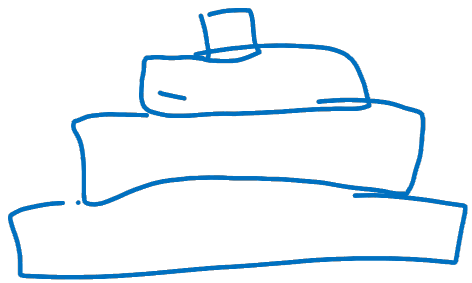
عالم

سياسيات

- In the first, economists employ the **scientific method**,

  تفكير علمي

  the dispassionate development and testing of theories about how the world works.



# Assumptions & Models

- **Assumptions فرضية**

- Simplify the complex world,
- make it easier to understand.

why?

- Example: To study international trade, assume two countries and two goods.

  **Unrealistic**, but simple to learn and gives useful insights about the real world.

- **Model: أفكار مبسطة لشرح المجسم**

- a highly simplified representation of a more complicated reality.

Economists use models to study economic issues.

# Some Familiar Models

A road map

# Some Familiar Models

A model airplane

# Some Familiar Models

The model teeth at the dentist's office

## Our First Model:
# The Circular-Flow Diagram

- The **Circular-Flow Diagram**: a visual model of the economy, shows how dollars flow through markets among households and firms
- **Two types of "actors":**
  - Households المشترين
  - firms المنتجين
- **Two markets:**
  - the market for goods and services G&S
  - the market for "factors of production" عوامل الانتاج

Consumer $

Labour

w

producer

HR

# FIGURE 1: The Circular-Flow Diagram

**Households**:

- Own the factors of production, sell/rent them to firms for income
- Buy and consume goods & services

Firms

Households

**Firms**:

- Buy/hire factors of production, use them to produce goods and services
- Sell goods & services

# Factors of Production

- **Factors of production**:

the resources the economy uses to produce goods & services, including

  - labor يد عامله
  - land ارض
  - capital (buildings & machines used in production) أي مبنى أي اله استخدمها عشان اسوي المنتج

# 4 factors of production FOP

# عوامل الإنتاج

1. •Land الأرض
2. •Labour العمال
3. •Capital راس المال
4. •Entreprener المستثمرين

# FIGURE 1: The Circular-Flow Diagram