Positive vs. Normative Economics

Positive Economics is concerned with questions of fact, which are in principle either true or false.

Normative economics is concerned with what ought to be. (involve judgment values).

Methodology

The way in which we examine economic questions will determine to which we are practicing positive or normative economics. (In truth it is very difficult to separate one from the other.)

Modernist Methodology (Considered by some to be the official methodology of economics.)

1. Prediction (control) is the goal
2. Only the observable implication of a theory matter
3. Observability entails objective reproducible experiments
4. If the predictions of a theory are shown to be false the theory is false. (the opposite is not true).

5. Objectivity is key, subjective observation is discouraged
6. If you cannot express it in numbers what is gained is unsatisfactory.
7. Subjective thought may be used to manufacture theory but cannot be use to justify the theory.

If modernism was strictly followed all economic theory would be rendered worthless (for better or worse). It would certainly stop any advances in economics

Falsification

If a theory's prediction are proven false the theory must be false.

It well may be that theory is proven false because it is impossible to adequately test the prediction. This is because most hypothesis' in economics cannot be isolated.

Well over 90% of economist believe that Tariffs and import quotas reduce the welfare of the nations involved.
A ceiling on rents reduces the quantity and quality of housing available.

These and other widely held predictions of economics cannot be adequately tested. Because we cannot isolate the effects of these phenomenon. Unlike physical science where they can usually isolate the phenomenon.

Questionnaires

Economist have long looked upon surveys as unscientific.

Milton Friedman

Compared surveys with the example of a billiard player and a physicist. Although a billiard player may be able to sink the ball does not mean he knows the physics behind billiards and any survey of billiard players would only serve to confuse the scientist.

Theory a set of explanations or predictions about various objects in the real world.

Models - a logical system.

A model becomes a theory when assumptions relating the theoretical constructs to real objects are added.

A theory (model) is can be though of as a story (metaphor).

Managerial Economics

Manageral Economics - Applies economic tools and techniques to business and administrative decision making.

Decision Problems

Price and output
Produce or buy
Production technique
Inventory Level
Advertising Media and Intensity
Labor Hiring and Training
Investment and Financing

These problems can be solved by using **Decision Sciences** and **Economic Concepts**.

Decision Sciences
Numerical Analysis
Statistical Information
Forecasting
Game Theory
Optimization

Economic Concepts
Theory of Consumer Behavior
Theory of the Firm
Market Theory

Profit Maximization and Expected Value Maximization.

Value

The Value of a firm is the **present value** of future profits. (slightly different from market value, b/c retained earnings and dividends)

Profits = Total Revenue - Total Cost

Therefore a company needs to increase the difference between total revenue and total cost in the future to increase the value of the firm.

Profit

Business vs. Economic profit

Risk adjusted normal rate of return- just enough to keep capital.

Constraints
Technology
Resources scarcity (liquidity, labor input, ect.)
Contractual obligation
regulations

Limitation of the Theory of the firm
principle-agent problem

Managers may do what is in their best interest instead or what is in the best interest of the owners.

Therefore they will seek satisfactory solutions instead of optimal solutions.

Fricitonal theory -shocks cause economic profit changes.

Monopoly theory

Innovation theory - reward innovation (inventions & modernization)

Conpensatory theory -rewards efficiency
Above normal profit rewards efficiency and innovation and attracts new entrepreneurs into industry. Below, opposite.

This has the effect of allocating scarce resource to their most productive use.

Businesses Role in Society.

Private vs. Social costs and benefits