

BEC1116

Principles of Economics

Basic Knowledge about Economics

What is Economics?

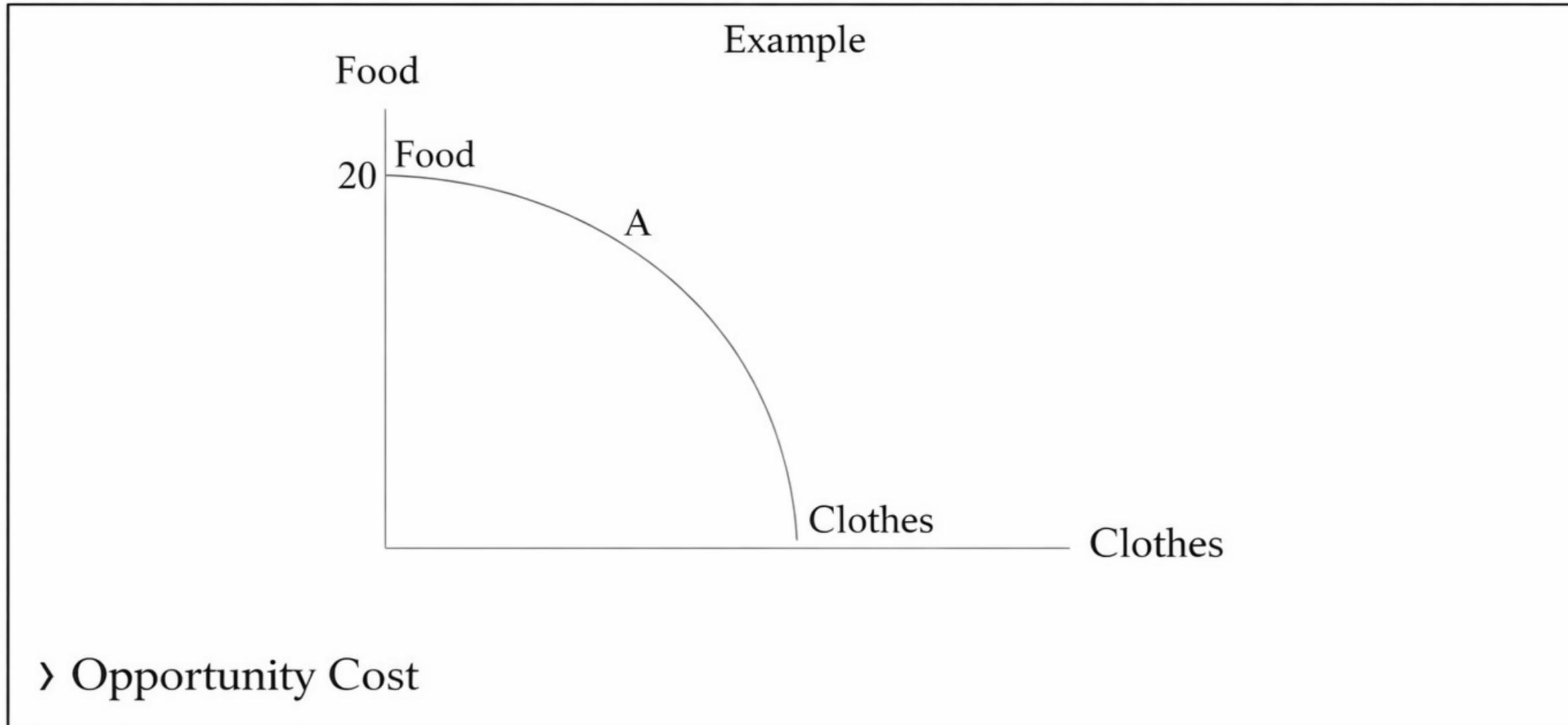
- Using limited resources efficiently to maximize benefits.
- Human wants and needs in society are unlimited.
- Making decisions (Make Decision) or making choices (Make Choice).

Scarcity, Choice, and Production Possibility Curve

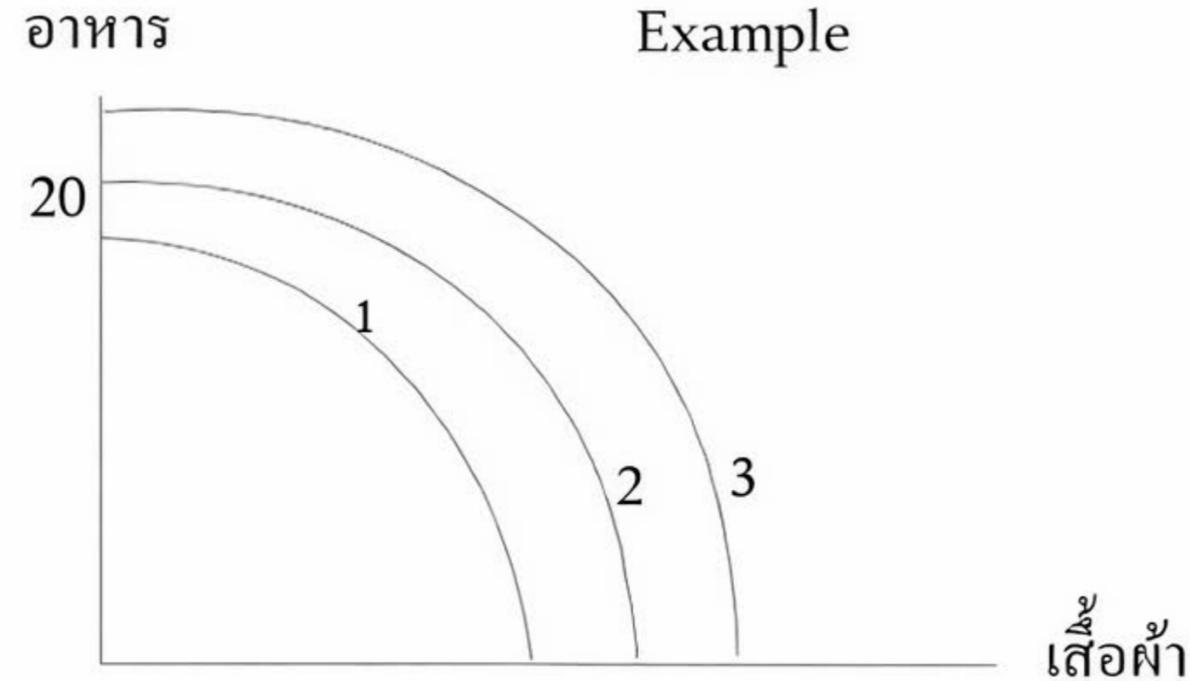
- The problem of unlimited human wants combined with limited resources (Scarce Resource) of the economic system.
- Leads to decision-making in selecting the use of resources in one direction.
- Production possibility curve (Production Possibility Curve : PPC)



Production Possibility Curve : PPC



The Shift of the Production Possibility Curve : PPC



The shift of the production possibility curve occurs when the resources of the economic system increase. For example, ...

- There is an increase in the labor force of the country, or
- New technological advancements are discovered, allowing more production using the same resources.

Factors of Production, Goods, and Services

- **Factors of Production**, resources in the economic system arising from nature (such as land, water, minerals) or human creation (electricity, machines, technology).
- The factors of production can be classified into 4 types:
 - Land
 - Labor
 - Capital
 - Entrepreneur



Factors of Production

- 1. Land:** Natural resources such as land emerging from nature, yielding rent to landowners.
- 2. Labour:** Human resources participating in production, receiving wages in return for their labour.
- 3. Capital:** Assets to be used in production (such as tools, machines) with capital called **interest** in return for capitalists.
- 4. Entrepreneur:** Organizes the production process combining all factors of production and is rewarded with profit.



Goods and Services

(GOODS AND SERVICES)

- **Economic Goods:** Goods and services that are produced from limited resources and have prices exchanged in the market, such as food, electrical appliances.
- **Free Goods:** Are goods that mainly exist naturally, such as water in the sea and rivers, rain, or breathable air. These are different from scarce resources used for producing goods, such as rainwater or air.

Therefore, when talking about goods and services within economics, it refers specifically to economic goods only.

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Basic Economic Problems

- **What to produce?** Society must decide what limited resources will be used to produce, how many will be produced, and what will be produced first based on people's needs.
- **How to produce?** Society must determine by what method and process these goods and services will be produced, and how many resources will be used for each in the most efficient way.
- **For whom to produce?** When goods and services have been produced, society must decide how to allocate them to individuals or groups in society fairly and in the most appropriate way.

The solving of these problems depends on the characteristics and economic systems of each society.

Economic System

- **Capitalist/Free Market Economic System**

Goods and services are produced and exchanged through the market system as prices guide society to recognize what to produce.

- **Advantages:**

Individuals engage in economic activities, consumers seek the highest satisfaction, producers aim for the highest profits, leading to the most efficient use of resources at all times.

- **Disadvantages:**

Those with large capital (money) have greater opportunities to produce goods and services than other investors.

- Intense competition >> small or new producers may not survive, leading to monopoly >> unequal distribution of production/income.

Economic Systems

- **Socialist Economic System**

Resources in the country are owned by the state, which decides what goods to produce and how to distribute them to whom.

- **Advantage:** The advantage is the absence of the problem of inequality.
- **Disadvantage:** The disadvantage is the lack of incentives and encouragement for economic activities; for instance, there is no motivation for those under rigid state control.

- **Mixed Economic System**

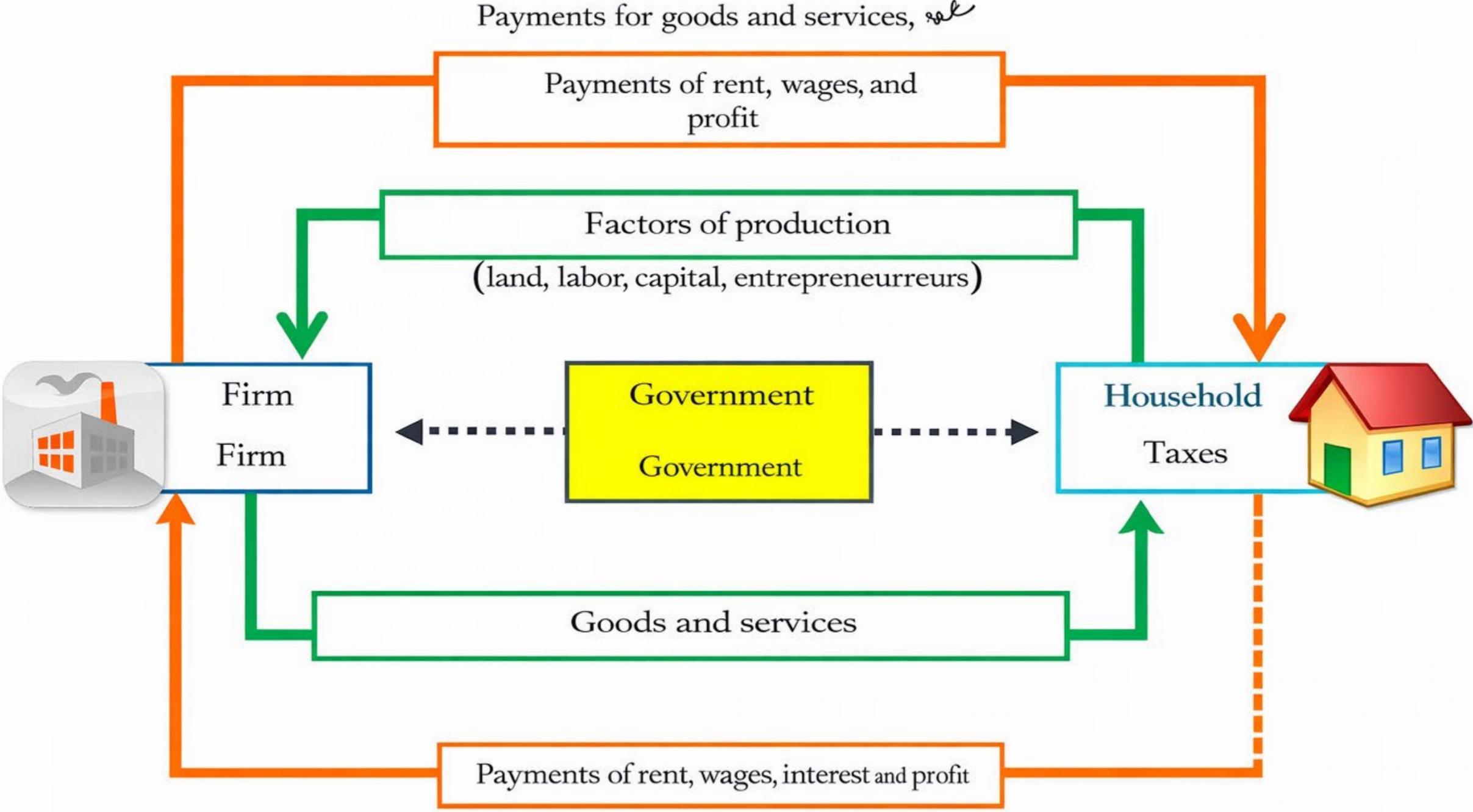
Most countries employ a mixed economic system where the private sector conducts economic activities under the free market while the state takes care of essential activities such as electricity, water, and national defense.

Economic Units and Relationships in the Economic System

The economic system consists of 3 units categorized by economic activities.



Circular Flow of Relationships Among Economic Units (Rent, Wages, Interest, and Profit)



Branches of Economics

- **Microeconomics**

Studies the economic behavior of individual economic units such as consumer behavior, firm behavior in industries, savings behavior, investment behavior, and examines how market and price systems allocate goods, services, and resources following the principles of economics.

- **Macroeconomics**

Studies the economy as a whole or the national economy, including total production, consumption, investment, national income (GDP), inflation (aggregate price level), etc.

Characteristics of Economics Theories

1. Positive Economics —

Seeks to understand phenomena in the economy and simply inform **what is (What is it?)**. It possesses the characteristic of being a science that can be tested, studying cause and effect phenomena in economics.

2. Normative Economics —

Studies various phenomena regarding **what ought to be (*What it ought to be?*)** or should be corrected or addressed in society. Aims to determine what direction it ought to be as it does not have the characteristics of being a science because it involves values, ethics, and one's perspective alongside this study.

Steps in Building Economic Theories

1. Identifying the problem under study

2. Defining the variables under study

- **Independent Variable** —

The variable determined by other variables. For example, in a study focusing on demand, price of goods is an independent variable that determines the quantity demanded to increase or decrease

- **Dependent Variable** —

The variable influenced by other variables. For example, the quantity demanded of goods is a dependent variable that increases or decreases based on other variables

3. Setting assumptions

- Rational human economic behavior (Economic Rationality)
- Other factors remain constant (Other Things Being Equal)

Steps in Developing Theories

4. Data Collection

- **Historical Method (Historical Method)**
 - **Deductive Method:** It is a method of theory development that begins with a hypothesis. By assuming cause and effect according to the scientific method, a test is conducted against real evidence. If it aligns with the hypothesis, the hypothesis must be able to summarize into a theory.
 - **Inductive Method:** It is a method of reasoning by gathering evidence from phenomena or data to analyze, summarize relationships, and then creating rules or theories to be used to explain other events.

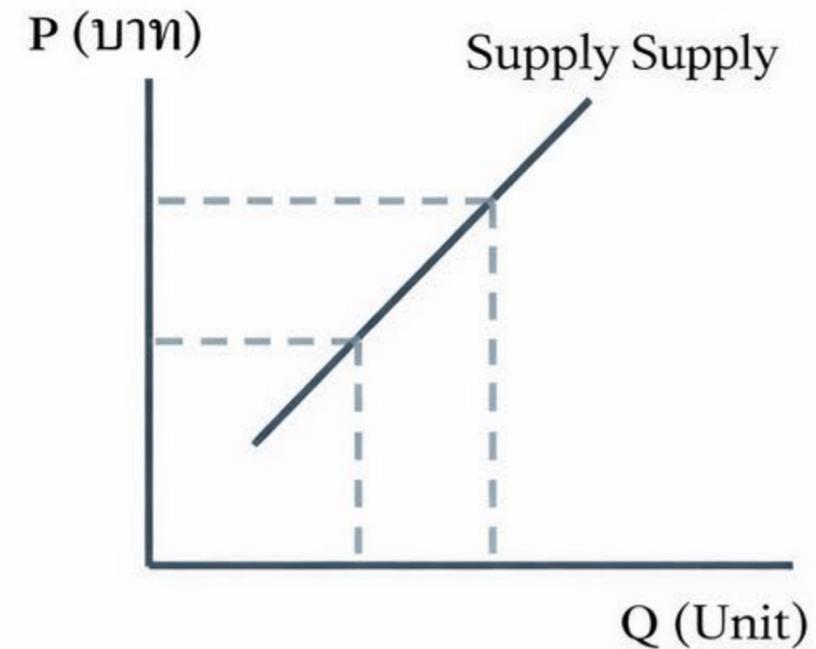
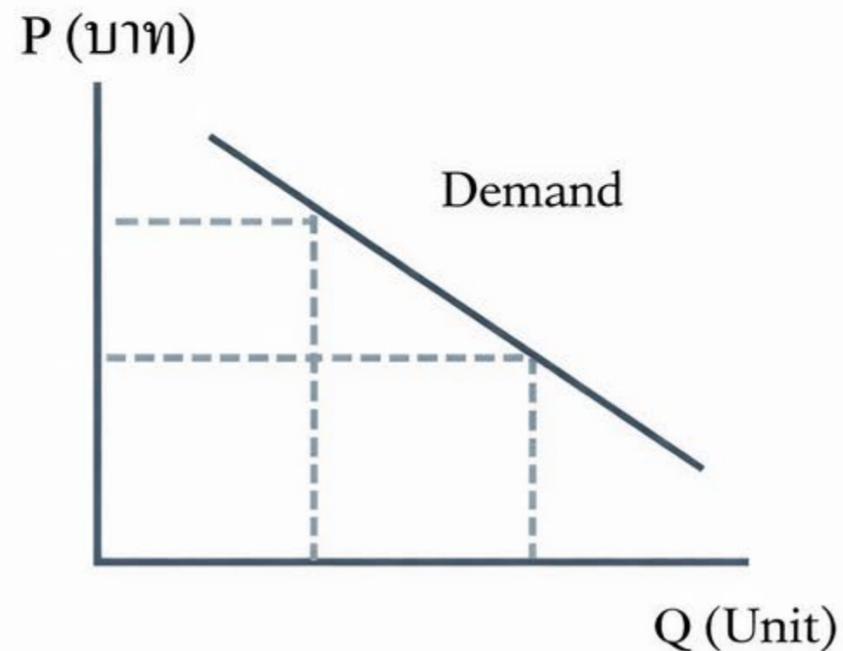
Methods of Economic Study

1. By Descriptive Approach (Descriptive Approach)

Study economic issues through descriptions of events as to what happened when a specific event occurs. The initial study of economics in short-term nature.

2. By Graphical Approach (Graphical Approach)

It is displaying relationships between variables in the form of a graph that shows variable values along the vertical and horizontal axes.



Methods of Economic Study

3. By Mathematical Approach (Mathematical Approach)

It is the study of economics at a higher level, using mathematical principles to represent relationships between variables that can be used to examine and find the most precise conclusions to problems brought in for analysis.

