

Chapter 1

INTRODUCTION

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The presence of quite a number of people who style themselves as economists is an index of the popularity of economics. This is also one of the many reasons why economics is often misunderstood. On the one hand, it seems to be an easy subject, especially to those who have mastered the art of getting rich and therefore feel qualified to speak on economic affairs. On the other hand, the student often finds economics a difficult but also challenging subject. By the time he has passed the course, any student of a good course in introductory economics will discover that many self-styled economists, when they attempt to explain or advocate something, are often wrong. When they are correct in their conclusion, it is often for the wrong reasons.

1.1 WHAT ECONOMICS IS

The one-sentence definition which comes closest to the nature of economics is that popularized by one modern economist. Economics is "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses." The key words in this definition are:

1. science
2. human behavior
3. ends

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4. scarce means
5. alternative uses.

1.1.1. Economics is a science. The theory of economics is a body of knowledge which is systematically organized. Economic theorists have built "models" designed to explain economic behavior. These models are based on certain assumptions and lead to certain logical conclusions. These theoretical models range from the explanation of the behavior of large economic units, such as the country's or the world's economy, to that of the most minute economic units, such as the individual consumer and the firm. They also attempt to explain how economic events happen, such as prices, business cycles, or inventory accumulation. The validity of these models can be tested with empirical evidence; that is what makes it a science.

1.1.2. Economics is a social science. Because it is concerned with the study of human behavior, economics is a social science. Therefore in the sense that it studies human behavior, economics has common ground with other social sciences like politics, psychology, sociology, anthropology, and the like. Unlike the so-called experimental sciences -- physics, chemistry, and biology -- the social sciences are not able to investigate the object of their study -- human beings -- under laboratory conditions (where all other things can be kept under strictly measurable magnitudes) so that exact results are obtained from experimental tests. Yet if there is a prima donna among the social sciences, economics would be she. Anybody who has been exposed to the discipline of economic study would be impressed by the logical structure of economic theories and by the fact that economists are probably the social scientists who have been most successful in formulating empirically-testable theories and carrying out those tests. The literature of economics has become highly specialized of late, and economists have used as much of the

exact tools of knowledge -- such as mathematics and statistics -- to enable them to establish conclusions on firmer ground. Yet, one is warned that among economists there are disagreeing schools of thought. The comforting thing about this disagreement, however, is that more often, those who belong to any camp know that the difference in conclusions stems from a difference in assumptions, which each maintains to be crucial and necessary.

1.1.3. Economic units have diverse objectives. Individuals, firms, and nations have many objectives or ends. The objectives may be economic or noneconomic. Individuals may think of high consumption levels, maximum security in a job, high social standing; firms may want high profits, goodwill, security; nations may desire high rates of economic growth, high per capita consumption standards for their citizens for the present time, a reasonable degree of political and economic independence. Etcetera.

1.1.4 The means by which objectives are attained are scarce. It is useful first to make a distinction between free goods and scarce goods. A free good is something available in limitless quantities so that it has a zero price. The air we breathe is a classic example of a free good. Every living creature should appreciate how important this is, and therefore we should caution ourselves against committing the fatal mistake of saying that since a good is free, it is useless. If all goods were free, there would be little use for economic study. Air can become a scarce good when it is stored for special uses, because one has to exert effort and use some resources to store it. One is reminded of the air used to pressurize modern airplanes, the spaceship cabin of the Russian or American spacemen, or even the more down-to-

earth example of compressed air for use in hydraulic pumps or for seadivers.

Any scarce good is often called an economic good. An economic good must have a non-zero price on it. Most goods have positive prices. The performance of a given service by a person or an input has to be compensated in terms of a positive price -- so many pesos per unit of time (day, month, or year). Garbage, however, is an economic good and it has a negative price. Some effort (cost) is incurred in getting rid of it. Thus, an economic good with negative price is one with a corresponding disposal problem. When economists talk about goods without any qualification, they mean an economic good. In the subsequent pages in this book, the word good, unless qualified, will have this obvious meaning.

The means available to attain the objectives of economic units are scarce. We may identify these means as resources which are inputs in production activities. The combination of these inputs or resources will lead to a given output. These inputs may be broadly classified as follows: labor, capital, natural resources, and knowledge.

Labor. This is a very familiar term, since the work performed by people is considered labor. There are of course different types of labor. At once, we can divide these types broadly into unskilled and skilled. Some labor requires little or no training, just some amount of strength or patience. One can have countless examples of unskilled labor -- stevedores, street-sweepers, construction help, and many others. There are many types of skilled labor, varying by degree of the specialized training required. The carpenter is a skilled worker, so is the driver, the lathe operator, the engineer or the doctor. It is

quite clear that the level of education of each of the workers varies from pure apprenticeship or vocational training to college or even graduate school.

Oftentimes, it is important to differentiate between labor and management. Labor and management may be hired by a firm, but they perform quite different functions. Management organizes, supervises, and makes decisions; labor carries out management's instructions and decisions. Sometimes, management is associated with entrepreneurship. The entrepreneur is oftentimes a manager, but he is much more. He may be described as an innovating manager, whose imaginative decisions enable a firm to grow fast.

It is to be expected that different types of labor have relatively different levels of scarcities. That skilled labor is more scarce than unskilled should be evident, especially because learning skills takes time. Those trained with managerial skills (in college) are more scarce than owner-managers. On the one hand, the entrepreneur is more scarce than the manager. A rough test of the scarcity of these different grades of labor will be to examine their average incomes. The lowest income receivers are likely to be unskilled workers and the highest income, the very skilled.

Capital. Capital has different meanings to many people. In economics, capital often stands for the stock of goods which are used in helping produce other goods. Under this definition, machinery, equipment, buildings are capital or capital goods. It takes time to produce capital goods. Capital formation or investment is a process characterized by increasing the capital stock. Increasing the capital stock enables the country or a firm to produce more. Generally when more of capital is available, more of labor and other resources can also be employed and, in con-

sequence, more output can be produced. In order to produce capital goods, a country or individual has to forego consumption, or the present enjoyment of goods. With the available stock of capital in any given time, a nation can choose to produce goods that will enable its citizens to consume more. But if a nation has to increase its ability to produce more consumption goods in the future, it has to postpone some present consumption and channel this to increasing the capital stock. We cannot eat a machine, but a machine, with the help of other inputs, can be made to produce more of the things that we eat. Another example, which reflects more fully the principle of consumption sacrifice, is the farmer's carabao. A carabao can be slaughtered to provide meat which can be consumed today. But a farmer may choose to forego the meat (or the immediate income from slaughter) so that the carabao can be helpful in his plowing and/or in procreating more carabaos. Whether it is the rice or the new carabao meat which results, the postponement of the slaughter enables the farmer to have more consumption in a future time.

Sometimes, capital refers to the means of financing investments. Thus, a businessman borrows capital from a bank in order to set up or expand a business. However, a careful examination of the expenditure for which this borrowed capital is made will often reveal that it is for capital goods. At other times, capital refers to ownership certificates for a given firm's assets. Thus, in a corporation, any owner of shares or stock is said to own a portion of the corporation's capital stock. Moreover, the origin of the word capitalist which is used loosely in talk having ideological overtones is based on this ownership concept.

Natural resources. Land, rivers, and mineral resources are endowed by nature and are therefore fixed. Their relative scarcities would depend on their uses. Thus, land was almost free many centuries ago in the Philippines and only recently in Mindanao. The American West, until it got settled, is also an example of land being a free good at one time. Petroleum was worthless until uses for it were discovered.

Knowledge. Knowledge is also an important means. Before somebody invented the steam engine, animal-water- or wind-power was the only thing available to make a vehicle travel or a machine churn. And, of course, under present standards, little could be accomplished then. Present knowledge limits what can be achieved. So we hear the economist or engineer say, "Under present technology, we can expect this much output." Knowledge can only be advanced through research, and it can have an effect on economic processes through the application of this research to actual production processes. Thus, technological progress often implies the application of new knowledge. A whole chapter will be devoted to this topic in this book.

The root of maximizing behavior so crucial in the analysis of the behavior of economic units is the scarcity of resources. Economic units maximize the attainment of a given objective or objectives subject to the available (scarce) means. The efficient allocation of scarce resources is a fundamental problem of economics. The individual consumer has only a given budget (or income) in deciding between one set of goods and another. The firm, likewise, has a given budget in deciding how much among a number of inputs to use, to achieve the highest attainable output possible. The nation can try to achieve the maximum growth of the economy within the limit of resources available to it

-- natural resources, capital, labor, agricultural output, etc.

1.1.5. Goods have alternative uses. This is an obvious thing. A given peso can be used to buy a number of different items; it cannot be used to buy all of these. My time at 8 a.m. Sunday can be used for many things -- sleeping, playing, reading a book, or doing housework -- but I can do only one thing. A piece of land can be used as a residential area, a rice-field, a sugarfield, or a forest.

Opportunity cost is a concept designed to describe the price that a good would receive if it were used in an alternative activity. The price of a good is often an indication of the opportunity cost of that good. A relatively more scarce resource will be priced higher than a relatively less scarce one. The skilled surgeon would have higher income than the average doctor, the businessman than a clerk, and, for that matter, the economist than the historian.

1.2 WHY ECONOMICS AND DEVELOPMENT

Whether we like it or not, economic events affect our lives. Whether we live in a society (as we all do) or alone (like the shipwrecked Robinson Crusoe) some of the choices we have to make are of an economic nature. Most of us know that where there is prosperity, the wages and other incomes of people are likely to be high. If business suddenly contracts by one half in volume, the same people will suffer, perhaps others are laid off and the ones remaining suffer cuts in salaries. If our money incomes rise but fail to catch up with price increases, our real incomes fall since we are not able to buy as many goods as before. Most of us go to college to prepare ourselves

for larger opportunities in the future. We forego present earnings for future and better earnings. Likewise, Robinson Crusoe's motive in building first a fence and hut might have been purely personal and psychological (to protect his life and to make it more comfortable than it would otherwise have been), but when he did this, he performed an activity which is economic in nature. He built a habitable place to live in, and in effect he performed an act of capital formation. By performing this act, he was able to protect himself against all hazards and was able to organize more effectively for his daily (economic) problem of survival.

Economics is important, and most of us need not be told about this. But we have pointed out, too, that economics is a science -- a social science -- and all sciences have to be studied because they form a body of knowledge. Then, formal study is necessary to make one understand the nature of economic events. Only then is it possible for any one to judge whether an economic policy or one economic event will have this or that consequence.

While economics as a formal discipline has its "basic principles," we also have to place emphasis on which principles are relevant to a country at a given time. Even the choice of topics to present in the beginning course in economics is an allocation problem. Given our limited time, we wish to study the principles most relevant to the institutional and economic environment.

In this country, as in many countries of the world, the problem of increasing per capita incomes and welfare is a very important one. The phrase "economic development" sums up this problem. Although

we recognize that this is a very complicated problem to which not one of the social sciences can give a definite answer, economics can give clues to many of the important aspects of economic development. Therefore, we emphasize economics and economic development. Whenever possible the economic principles are applied to questions useful in the understanding of economic development.

1.3 THE PROGRAM OF THE NEXT CHAPTERS

Chapter 2 takes the reader to a discussion of Philippine economic history from the pre-Spanish to the American period. This chapter is an original research based on the author's work in the libraries and archives of Spain, England, and elsewhere.

In Chapter 3, the study of economics proper begins. In the first half of the chapter, the theories of consumer behavior and of the firm are presented. The second half is on the behavior of economic aggregates -- national income, employment, saving, investment.

Chapter 4 is on the aggregative concepts introduced in the immediately preceding chapter. National income concepts are defined and their logical structure are analyzed in the context of the Philippine income account.

Chapter 5 is a study of money, prices, central banking, and the commercial banking system. The latter part of the chapter discusses the whole financial system.

Chapter 6 covers a study of the public finances. After a survey of the scope of the operations of the public sector, the patterns and trends of government expenditure in the Philippines are discussed. Principles of taxation and the incidence of the current tax structure

in the country are then reviewed.

Chapter 7 is a discussion of international trade and the special role it has played in Philippine economic progress. Inevitably the chapter covers a discussion of tariffs, balance of payments, and current trade policy in the Philippines.

Chapter 8 is on industrial growth, markets and business organizations, while Chapter 9 is on the role of agriculture in the Philippine economy. In Chapter 10, the important question of technical progress, innovations, investment in man and economic development are discussed. Chapter 11 relates the role of population to economic development.

In Chapter 12, the social costs of economic development are considered in detail. Chapter 13 is concerned with the comparison of economic systems and the many forms of economic planning.

1.4 FOR THOSE WHO WISH TO READ MORE

The student eager for more learning may wish to go ahead with reading other published works. Some of the chapters contain additional reference materials at the end. The student who wishes to supplement his studies, however, is better advised to keep away from newspaper columns purportedly designed to inform on economic affairs. Some columns make sense, especially if the persons writing them have the particular competence; and there are such persons. Others are both harmless and useless. Too often, however, they can mislead the untrained mind.

Naturally, an introductory course is nothing but an introduction. Those who wish to go farther in their

readings may want to tackle books on the Philippine economy. An interesting, but voluminous and somewhat dated, reading would be Frank H. Golay, The Philippines: A Study in National Economic Development (Cornell University Press, 1961). A compilation of articles by many of the country's economists, within the comprehension of most beginning students, can be found in G. P. Sicat (ed.), The Philippine Economy in the 1960's (Institute of Economic Development and Research, 1963). A slightly more technical reading is Richard W. Hooley, Saving in the Philippines (Institute of Economic Development and Research, 1963), the subject matter of which is self-explanatory. A highly readable contribution to the understanding of the tax system in the Philippines is one prepared by the Joint Legislative-Executive Tax Commission, A Study of Tax Burden by Income Class in the Philippines (1964). Now and then major studies of the Philippine economy are published by the Institute of Economic Development and Research of the University of the Philippines School of Economics. The literature published in the Philippine Economic Journal provides up-to-date reading on issues of interest to economics students and the profession in general. Most articles of importance on the Philippine economy are published in this Journal, but they are generally technical in nature.

Those who wish to read some material on Southeast Asia and the Philippines can also avail themselves of the ECAFE (Economic Commission for Asia and the Far East) annual surveys of Asia and the Far East. These surveys contain interesting reports of yearly economic developments in countries within Asia; sometimes they review special aspects of the economies covered by the region over a wider span of time.

Statistical data are helpful in the understanding of economic phenomena, but they often require the interpretation of trained minds. The more important economic statistics in the Philippines are contained in Central Bank of the Philippines publications, for instance, the Annual Central Bank Reports or the quarterly Statistical Bulletin. National income statistics are prepared by the National Economic Council, and important census and survey data are undertaken and reported by the Bureau of the Census and Statistics. United Nations publications, either by the ECAFE or by other United Nations organs, also report economic statistics about many countries in the world, including the Philippines.

Eventually, the student who wants to read further in economics would probably get interested in studying more specialized courses. A treatise-like introduction to economic principles is Paul A. Samuelson, Economics: An Introductory Analysis (McGraw-Hill). This book has now appeared in several editions. Or someone might wish to go into more intermediate level study in economics. Here there are a number of specialized texts. The subject matter of economic theory may be split into the following: price and allocation theory (often known as microeconomics), national income theory (macroeconomics), money and banking, international trade, and public finance. Many other fields of economics are applications of one or the other of these basic fields. Some works in the field of economic development have appeared lately. The most widely read textbook on the subject is probably Charles P. Kindleberger, Economic Development (McGraw-Hill), now in its second edition, but there are a number of excellent substitutes. The progress of economics as a science can be found mostly

in the many technical journals in economics. The articles appearing in these journals are really mostly for specialists and hardly ever readable by laymen or undergraduates.