BASIC ECONOMICS

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CHAPTER 1

NATURE AND SCOPE OF ECONOMICS

Learning Objectives:

- Explain the differences between macroeconomics and microeconomics.
- Apply the concepts of scarcity, choice and opportunity costs for making smart choices.
- Discuss the types of factors of production
- Explain the difference between the positive and normative economics

"There is no such thing as abundance… that's why there is Economics".

In a day to day activities, there are a lot of things that we encounter. New situations, new persons, things but one thing does not change, that individual make decisions.

Decision making is not new to us; the moment you wake up, you wake up, you make a decision. Will I wake up early of not? Will I wear my uniform or not? Will I commute or ride with my car and others. Even when we buy commodities, will I buy branded clothes of the common one? The question is, why do we need to decide and how we are going to make a decision?

The answer to the first question is because we have a lot of choices and once we choose one alternative there is something we need to give up. That is why ***economics*** arises.

What is Economics?

Economics came from the Greek word **"oikos"** which means home of household and **"nemein"** which means management. Therefore, economics means management of the household. This is the basic unit of society of Greece. It shared with the etymology of the field of **ecology.**

If we are going to define **economics,** it is a **social science** that deals with the **proper allocation of scarce resources to satisfy the unlimited needs and wants** of the society. It is also called as the art and science of decision making.

Economics is social science because it deals with the interaction of business and consumer. We study the taste and preferences and the behaviour of people toward a certain product.

Economics is proper allocation of scarce resources. Definitely we need to allocate because there is scarcity. **Scarcity is the basic problem of economics**. Scarcity is the limitation that exists when people obtain the goods and the services that they need. Economics will not exist unless there is scarcity. Scarcity is the situation in which the resources available are not enough to meet its objective.

If we are going to observe our environment, we can notice that we have a lot of resources such as water, air, labor and other.

We have scarcity because of unlimited needs and wants of the people. Our satisfaction for goods and services is insatiable, meaning once people are satisfied, he will look for another thing that can satisfy him again.

Economics as an Art and a Science

There have been numerous questions whether economics is an art or a science. Economics is an art as well as a science. Economics is an art because different theories and laws are explained with the help of graphs, figures, tables, equations. Also economics make use of assumptions which helps to define the conditions for the application of theories, laws and relationship between economic variables.

Economics is a science because it is a systematized body of knowledge in which economic facts are studied and analyzed. Economics just like science have laws and theories which trace out a causal relationship between two or more phenomena. For instance the law of demand tells us that, all things being equal, a fall in price leads to an increase in demand and vice versa. A rise or fall in price is the cause while the decrease or increase in demand is its effect.

Economics is also a science because its laws possess universal validity such as the law of demand, law of diminishing marginal utility, etc. Some people do not regard economics as a science because there is no scope for experimentation. Science involves collections of facts and testing them by experimentation. Economic phenomena are complex because they relate to man who acts irrationally as a result of tastes, habits, social and legal institutions in the society. Although economics deal with statistical, mathematical and econometric methods for testing, but they are not so accurate to judge the true validity of economic laws and theories. As a result, exact quantitative prediction becomes impossible. For instance, a rise in price may not lead to a reduction in demand rather may increase demand because people are scared of shortages in future.

But this does not mean that economics is not a science. It is rather classified as a social science because it deals with human beings whose actions are so filled with uncertainty.

Basic Economic Concepts

***Scarcity:* -** Scarcity means limited in supply. According to Thomas Sowell, the first lesson of economics is scarcity. There are three categories of economic resources: Land, labour and capital. Each of these resources exists in a finite, limited quantity. People have unlimited wants and since we have a limited amount of resources it means we can only produce a limited amount of goods and services, that is, the limited resources cannot produce enough to satisfy everyone's unlimited wants. This gives rise to the study of economics for better allocation of scare resources among competing and insatiable needs so as to maximize welfare.

Choice: A choice is a comparison of alternative. The problem of scarcity leaves us in a situation in which we must constantly choose which of our wants we will seek to satisfy. For instance, an individual consumer must choose among the types of goods and services to consume because of his limited income. He must also choose between spending on present consumption and saving for future consumption.

The firm with its limited capital must decide what to produce and what not to produce. A situation where the firm wants to produce two commodities, the choice to produce more of one would mean a resolve to produce less of the other.

Scale of Preference**: -** In economics, it is assumed that man is rational in his choice making, that is, if a man has to choose between one thing and another, it is expected that he will always choose the alternative that will yield the greatest satisfaction. Similarly a firm faced with how to make a choice between production of one product and another, will choose the product that will yield the greatest profits. Scale of preference presents a list of wants arranged in order of importance with the most pressing want listed first, followed by the second most pressing need and so on.

***Opportunity Cost:* -** Opportunity cost means forgone alternative. People must make choices because of limited resources. Every choice has an opportunity cost and so the satisfaction of one want involves forsaking the other. Therefore the real cost of satisfying any want is the alternative forgone or the opportunity cost. For instance, suppose a community uses a land and other resources to build a school instead of a factory, the opportunity cost of choosing the school is the loss of the factory and what could have been produced by building the factory. Also if a student misses his lecture on economics because he wants to go to the cinema, the cost to him is the lectures that he decides to miss. Opportunity cost of any choice is the value of the best alternative forgone in making it and not simply the amount spent on that choice.

Central Economic Problems of any Economy

All modern economies have certain fundamental or basic economic problems to deal with. The limited resources have led to the problem of how to assign the scare resources in order to achieve maximum satisfaction. There is the need to economize and utilize these resources in the most efficient manner in order to satisfy the welfare of the society. These problems are called central economic problems because other problems revolve around them. They are:

1. **What to produce: -** This has to do with the problem of allocation of resources among different goods and services. It involves selection of what should be produced and in what quantity in order to satisfy consumer wants as best as possible using the available resources. The society has to choose among different kinds of goods and decide on how to allocate resources among them, for instance whether to produce capital goods or consumer goods. The society also needs to determine the specific quantity of each type of good to be produced. In a market economy, the choice of what to produce is made by the buyers in other to fulfill their needs. Government can through its laws determine what to produce in a given economy. But the production of one good means a reduction in the production of another.

2. How to Produce: -This problem refers to selection of appropriate technique of production, that is, how to combine resources in other to produce goods and service in a more efficient way and at a minimum cost. A combination of resources (factors) implies a technique of production. The technique of using a combination which involves less capital and more labour is known as labour-intensive mode of production while a combination of more capital and less labour is capital-intensive mode of production. The decision on which resource combination to use depends on availability of factors and their relative prices. Therefore, it is in the interest of the society that factors should be combined in a manner that maximum output can be produced at minimum cost, using least possible scarce resources.

3. For whom to produce: - This economic problem focuses on how the national product is to be distributed among the members of the society, that is, how the consumer goods and capital goods will be distributed. The society has to decide who receives the outputs produced in the economy because human wants are unlimited. Should the economy produce goods for those with high incomes or for those with low income? What demographic group should production be targeted at? The money income of the people determines the distribution of output in the society. The greater ones money income, the greater the quantity of goods the person will purchase from the market. Sometimes the supply of goods are in short supply leading to government intervention through price legislation, rationing or through quotas.

What provision should be made for economic growth?

This problem deals with how to decide on how much saving and investment should be made for future economic growth. No society or individual would like to use all its scarce resources for only current consumption or else future production will remain stagnant leading to a decline in the levels of living. The society should devote a part of its resources for the production of capital goods and for the promotion of research and development activities. Capital and technological progress achieved in this way will lead to production of consumer goods in the future and increase standard of living.

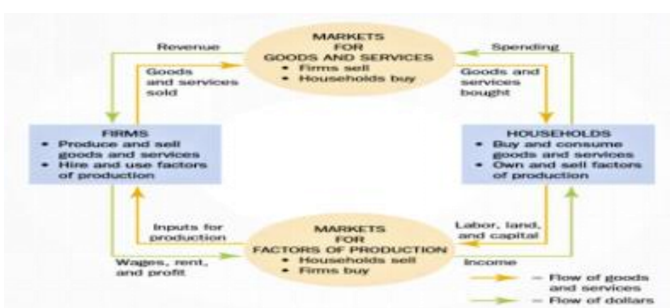
The Circular Flow Diagram

The economy consists of millions of people engaged in many activities—buying, selling, working, hiring, manufacturing, and so on.

To understand how the economy works, we must find some way to simplify our thinking about all these activities.

In other words…

We need a model that explains, in general terms, how the economy is organized and how participants in the economy interact with one another.



Above Diagram presents a visual model of the economy, called a circular flow diagram. In this model, the economy has two types of decision makers—households and firms.

Firms produce goods and services using inputs, such as labor, land, and capital (buildings and machines). These inputs are called the factors of production.

Households own the factors of production and consume all the goods and services that the firms produce.

Households and firms interact in two types of markets.

In the markets for goods and services, households are buyers and firms are sellers. In particular, households buy the output of goods and services that firms produce.

In the markets for the factors of production, households are sellers and firms are buyers. In these markets, households provide firms the inputs that the firms use to produce goods and services.

The inner loop of the circular-flow diagram represents the flows of goods and services between households and firms.

The households sell the use of their labor, land, and capital to the firms in the markets for the factors of production.

The firms then use these factors to produce goods and services, which in turn are sold to households in the markets for goods and services.

Hence, the factors of production flow from households to firms, and goods and services flow from firms to households.

The outer loop of the circular-flow diagram represents the corresponding flow of dollars. The households spend money to buy goods and services from the firms.

The firms use some of the revenue from these sales to pay for the factors of production, such as the wages of their workers.

What's left is the profit of the firm owners, who themselves are members of households.

Hence, spending on goods and services flows from households to firms, and income in the form of wages, rent, and profit flows from firms to households.

Example of Circular Flow Diagram

Let's take a tour of the circular flow by following a dollar bill as it makes its way from person to person through the economy.

Imagine that the dollar begins at a household, sitting in, say, your wallet.

If you want to buy a cup of coffee, you take the dollar to one of the economy's markets for goods and services, such as your local Starbucks coffee shop.

There you spend it on your favorite drink. When the dollar moves into the Starbucks cash register, it becomes revenue for the firm.

The dollar doesn't stay at Starbucks for long, however, because the firm uses it to buy inputs in the markets for the factors of production.

For instance, Starbucks might use the dollar to pay rent to its landlord for the space it occupies or to pay the wages of its workers. In either case, the dollar enters the income of some household and, once again, is back in someone's wallet.

4 Factors of Production

Anything that helps in production is the factor of production. These are the various factors by mean any resource is transformed into a more useful commodity or service.

They are the inputs for the process of production. They are the starting point of the production process. Factors of production are the parameters which affect the output of production.

Types of Factors of Production

Land

It refers to all natural resources. All natural resources either on the surface of the earth or below the surface of the earth or above the surface of the earth is Land.

One uses the land to produces goods. It is the primary and natural factor of production. All gifts of nature such as rivers, oceans, land, climate, mountains, mines, forests etc. are land.

The payment for land is **rent**.

Characteristics of Land as a Factor of Production

- The land is a free gift of nature.
- The land has no cost of production.
- It is immobile.
- The land is fixed and limited in supply.

Types of Land

Residential
Commercial
Recreation
Cultivation
Extraction
Uninhabitable

Labor

All human effort that assists in production is labour. This effort can be mental or physical. It is a human factor of production. It is the worker who applies their efforts, abilities, and skills to produce.

The payment for labour is the **wage.**

Characteristic

- It is a human factor.
- One cannot store labour.
- No two types of labour are the same.

Types of Labor

Unskilled
Semi-skilled
Skilled
Professional

Capital

Capital refers to all man made resources used in the production process. It is a produced factor of production. It includes factories, machinery, tools, equipment, raw materials, wealth etc.

The payment for capital is **interest.**

Characteristics

a) Capital is a manmade factor of production. B) It is mobile. C) It is a passive factor of production.

Types of Capital

a) Fixed b) Working c) Venture

Entrepreneur

An entrepreneur is a person who brings other factors of production in one place. He uses them for the production process. He is the person who decides

1. What to produce
2. Where to produce
3. How to produce

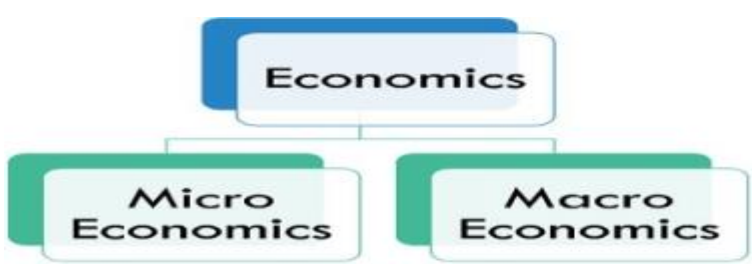
A person who takes these decisions along with the associated risk is an entrepreneur.
The payment for land is **profit.**

Characteristics

- He has imagination.
- He has great administrative power.
- An entrepreneur must be a man of action.
- An entrepreneur must have the ability to organize.
- He should be a knowledgeable person.
- He must have a professional approach.

BRANCHES OF ECONOMICS

Economics has two main branches, namely, **microeconomics** and **macroeconomics.** These branches are also known as the two main divisions of economics.



Microeconomics deals with individual behaviour or firms and household. It deals with specific area in the circular flow of diagram. i.e. a consumer, a household, a firm, an industry, etc. It analyses the way in which the decisions are taken by the economic agents, concerning the allocation of the resources that are limited in nature.

It studies consumer behaviour, product pricing, firm's behaviour. Factor pricing, etc. The examples of coverage of microeconomics are as follows:

- Price of rice
- Employment in San Miguel Food Corporation
- Production of Purefoods products
- Employment in Cebu Pacific

Macroeconomics studies the overall or aggregate behaviour of the economy as a whole. This includes the behaviour of firms and household together and treats them as one. In addition to the economic sector mentioned, there are government and foreign sectors that will affect the whole economy. The following are examples of areas concern by macroeconomics:

- Overall price (inflation/deflation)
- Employment in National Level
- National Output or Production
- National Income
- Interest Rate
- International Trade
- Foreign Exchange
- Unemployment
- Money Supply
- Aggregate Expenditures

Positive and Normative Economics

The output of economics usually express in policy and statement to enhance the current situation. To understand the nature of policy and statement, the student must determine the difference between positive and normative economics.

Positive Economics refers to the statement of what will happen? It deals with the question such as: Why do doctors earn more the waiters? What is the economic impact of raising taxes? These are difficult questions to answer but they can all be resolved by reference to analysis and empirical evidence. The examples of these statements are:

- The price of Bangus increases from Php110.00 per kilo to Php115.00 per kilo.
- Unemployment of the Philippines rises by 10%
- The GDI of the country is 3% higher than the GDI of Thailand

Normative Economics refers to the statement of opinion and stating what should be done or what ought to be. This cannot be proved ad disproved by anyone since this is an opinion. It involves ethical judgement and norms of fairness. Should poor people be required to work if they are to get government assistance? Should employment be raised to ensure that inflation does not become too rapid? There are no rights or wrong answers to these questions because they involve ethics and values rather than facts. They can be resolved only by political debate and decisions, not by economic analysis alone. The examples of this statement are:

- Government should monitor the supply of Bangus in wet market to avoid over pricing
- Individual must look opportunity outside the country to lessen the unemployment in our country.
- Economic policy maker should maintain the good performance of our country.

CHAPTER 1 EXERCISES

Name: ____ **Score: _________________**

Year/Course/Section: ____________________________ **Schedule: _____________**

ASSIGNMENT AND ASSESSMENT

Test I. Multiple Choice

Direction: Read each statement carefully then answer the question that follows. Choose the letter that best describes your answer. Write your answer on the space provided.

_____ 1. It is the study of home management.
A. Ecology C. Economics
B. Econometrics D. Economistry

_____ 2. What is the basic economic problem?
A. Scarcity C. Global warming
B. Overpopulation D. All of the above

_____ 3. What branch of science economics will fall?
A. Natural Science C. Physical Science
B. General Science D. Social Science

_____ 4. Which of the following is NOT a factors of Production
A. Land C. Labor
B. Capital D. Goods and Services

_____ 5. The analysis of the behavior of individual decision-making units is the definition of
A. Microeconomics C. Macroeconomics.
B. Positive Economics D. Normative Economics

TEST II. Identification

Direction: Determine whether the words or phrases being enumerated are concern of Microeconomics or Macroeconomics. Write **MIC** if it is concern of microeconomics and **MAC** if it is concern of macroeconomics.

__________ 1. Unemployment
__________ 2. Price of Rice
__________ 3. Number of goods produced by Uniliver
__________ 4. Politics
__________ 5. Price of Fuel

TEST III. Identification

Direction: Determine whether the statements are Positive Economics of Normative Economics.

________________________ 1. The price of LPG gas increases by 10%.
________________________ 2. Consumer should not be alarmed by this price increase.
________________________ 3. Supermarket must monitor the supply of Christmas goods to avoid shortages.
________________________ 4. Shortages are phenomenon in which demand exceed the supply.
________________________ 5. Shortage in sugar occurred last year in Metro Manila.

TEST IV. Determine the word being described by each statement.
_______________________ 1. It is payment for land.
_______________________ 2. It is the payment for labor.
_______________________ 3. It is the payment for service.
_______________________ 4. The items provided by the household.
_______________________ 5. They are the one who produces the product to be consumed.

MODULE 2 - READING

CHAPTER II

DEMAND AND SUPPLY ANALYSIS

OBJECTIVES:

* Differentiate Needs and Wants
* Define Demand and Supply
* Evaluate the Theory of Demand and Supply
* Know the Factors that Affect Demand and supply
* Recognize the Equilibrium Point and Price; and
* State the Law of Demand and Supply

While the hands of time keeps on moving, inventions and innovations keep at a fast pace in giving comfort and satisfaction to the people. Henceforth, these give rise to demand different thing. But is the demand for such product a need or just a want? Is it a must for us that we cannot live without it or just a piece of whims and caprice for us to give prestige and status quo?

Needs are the things that we must have for us to live like food, clothing or shelter. These are all basic needs that the absence of any one among the three would cause sickness that would lead to death. Our body needs food for health and likewise, we need shelter and clothes to secure us from harm and danger especially during bad weather. Houses are built for people as place for resting while clothes are made for people to protect themselves against harmful dangerous species, insect bites, protection from too much heat and cold. ***Wants*** are the things that will give us the state of ease and contentment. Sometimes, we really do not need a thing but we ought to have it because it gives us satisfaction.

Needs could be met but **wants** could not. **Wants** are the results of human's unsatisfied nature always asking for more, seeking for more, seeking for greater satisfaction that might result for his own suffering.

To better understanding the behaviour of the two economic sectors, we need to learn first the basic behaviour of consumer and producer; the **demand and supply**.

In this section, we're going to discuss the law of demand and supply, the factors affecting the demand and supply and the difference between quantity demanded and demand, quantity supplied and supply. This consider the ABC of economics or the plus or minus of economics.

DEMAND

Demand is the relationship between price and quantity demanded. It is also defined as the amount of goods and services that the consumer/buyer are willing and able to buy in different prices at a particular time.

From the definition, we can come-up to the much known concept in economics, the law of demand. **Law of Demand** states that as the price of the commodity increases, all other things remain constant **(ceteris paribus)**, quantity demanded decreases. There is a negative relationship between price and quantity demanded ceteris paribus. **Ceteris Paribus** is a Latin word which means holding other variable constant,

Demand can be represented in three forms.

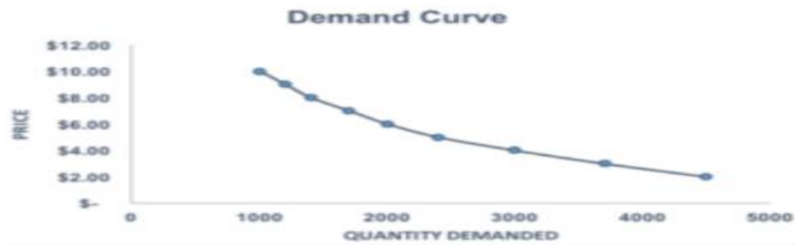
Demand Schedule is the tabular representation showing the price and quantity demanded for a particular good. This schedule shows the different quantities that will be bought by buyers at each of the given prices.

Price		Quantity Demanded
$	10.00	1000
$	9.00	1200
$	8.00	1400
$	7.00	1700
$	6.00	2000
$	5.00	2400
$	4.00	3000
$	3.00	3700
$	2.00	4500

Table 2.1

Demand Schedule of Good A (per kilo)

Demand Curve is the curve that shows relationship between price and quantity supplies. This is the graphical presentation of the demand schedule. This is downward sloping which implies that there is an inverse relationship between price and quantity demanded. The negative slope of the demand curve comes from the fact that when price decreases, it will bring new buyers. This is due to income effect. When the price of goods changes, this change will affect the consumer's real income. Real income is obtained from his money income. Increase in purchasing power means an increase in the quantity demanded for goods and services. If a good becomes more expensive, the real income of the consumers suffers and lessens their purchasing power. To cope with this price increase, the consumers buy less of that good. The opposite happens when the price of a certain good decreases. In this case, the consumer's real income increases and they can buy more of that good.



3. Demand Function is a mathematical model showing the relationship between price and quantity demanded. The demand function states that quantity demanded is a function of price. An example of the demand function is shown in equation 2.1

$$\mathbf{Qd = 3 - 4P}$$

CHANGES BROUGHT BY PRICE FACTOR

Movement along the Demand Curve/Change in Quantity Demanded

- This will happen if the price factor has been changed.

Case No. 2.1

The price of good X rises from Php3 to Php5. The changes occur based on the situation that the demand curve remains its position but the point will move along the curve as shown in Figure 2.2 panel A. The point moves from point A to point B. When price of commodity X increases, quantity demanded will be decreases.

On the other hand, the price of the commodity X decreases from Php5 to Php3, the quantity demanded for the product X increases from 10 to 15. This is shown in figure 2.2 panel B.

Movement along the Demand Curve

CHANGES BROUGHT BY NON-PRICE FACTOR

Shift of the Demand Curve/Change in Demand

- Shift of the demand curve occurs when the non-price factor changed. The following are the non-price factors that affect the demand curve.

1. **I**ncome
2. Number of **B**uyers (Population)
3. **T**aste and Preference
4. Price **E**xpectation
5. Price of **R**elated Goods/Products

For you to easy memorize the non-price factors just remember the acronym **BITER.**

1. **INCOME** – refers to the amount of money that the individual or household receives in providing the factors of production. It is divided into two: the **disposable income** and the **non-disposable income**.

Disposable Income is part of income used by individual to purchase the goods and services the individual or household needed. It is the one considered most by the economist whether there will be changes in demand curve or not.

Non-disposable Income is part of income that is not use by household or individual for their consumption. This is the part of income that is being saved for future purposes. Sometimes, it became an investment of household or individual in the future.

Remember**:** <u>The changes in disposable income affects the current demand, but if the overall income increases, it is more likely that the disposable income will also increases.</u>

In considering the income, goods can be classified as **normal** or **inferior goods**. The commodity is considered **normal good** if the demand for that good increase as the income (disposable income) also increases. Examples of normal goods are groceries and other shopping goods.

On the other hand, the commodity is considered **inferior good** if the demand for that good decrease as the income of individual increases. **Examples** of inferior goods are bargain sales goods. (ukay-ukay products), imitation products and others.

Remember: <u>Income has positive or direct relationship with the demand for normal good while income has negative or inverse relationship with the demand for inferior good.</u>

<u>Case No. 2.2</u>

Joseph, a carpenter earns Php3,000 a month. From his income, he usually consumes 25 kg. of rice a month and 20 cans of sardines every month. But when he was promoted as foreman and his income increases to Php5,000, he is now consuming 30 kg. of rice per month and 10 cans of sardines in a month.

In this case, rice is a normal good for Joseph while sardines are inferior goods to him. The changes in demand curve here is the shift of the demand curve as illustrated in Figure 2.3.

Figure 2.3 panel A shows the change in the demand curve for rice as income (disposable income) of Joseph increases. The demand curve shifts to the right. As we can observe in the graph, the demand for rice increases from 25 to 30 even the price of rice remains at 28. This is the reason why rice is considered normal good.

On the other hand, figure 2.3 panel B shows the change in demand curve of sardine. Considering that the income of Joseph increases, the demand for sardine decreases from 20 cans to 10 cans. The demand for sardine changes even the price of sardine is still 13. This is the main reason why a sardine in this case is consider as inferior good.

POPULATION – Demand is the relationship between price and quantity demanded by all consumers in the market. If the number of consumers increases, then demand will also increase. The demand curve will shift to the right.

Case No. 2.3

When the late 1990 came, most of the government agencies and some of the private companies took into consideration advanced studies as one of the requirements to promote an employee. What happened to the demand of graduate studies services?

Changes in Demand for Graduate School Services

Figure 2.4 Shows the changes on the demand curve for the graduate school services. As shown in the figure, the demand curve shifts to the right because there are additional potential customers who will enrol in the advanced studies. The more enrolees who will enrol, the higher the demand for the service.

TASTE AND PREFERENCES is the behaviour of consumer which is affected by weather, perception, information, occasion and the like.

Case No. 2.4

What will happen to the demand of halo-halo during summer? How about during rainy seasons?

In this situation for example: we prefer halo-halo during summer while during rainy seasons, we prefer not to buy it. Because of this, our taste and preference are being affected by the weather condition. Figure 2.5 shows the change that occurs in the demand curve of halo-halo.

Figure 2.5 panel A shows the changes in demand curve of halo-halo when the season change to summer. As mentioned earlier, demand for halo-halo will increase because we prefer it during summer. An individual may consume 10 orders of halo-halo a week during summer and 3 orders of halo-halo if not summer.

Figure 2.5

Changes in Demand Curve of Halo-halo during Summer and Rainy Season

Figure 2.5 panel B shows the changes in demand curve of halo-halo when the season changes to rainy season. Unlike the first panel, the demand curve shifts to the left because only few wants halo-halo during rainy days. Note, even the price did not change, the demand for halo-halo declines from 7 to 3.

4. **PRICE EXPECTATION.** If people expect the price of good to increase, they will want to buy it more at present before the price increases. Therefore, the entire demand curve will shift to the right. Conversely, if the people expect a price decline, they will purchase less of that good at present.

Case No. 2.5

What will happen to the demand of flowers during Valentine's Day? How about after the Valentine's Day?

Figure 2.6 shows the changes in the demand of curve of flower during and after the Valentine's Day.

Figure 2.6 panel A shows the change in demand curve of flower during Valentine's Day. As we all know, more people will purchase flower to celebrate the occasion. Therefore, demand curve shifts to the right from D1 to D2. At price Php300 per dozen of flowers, consumers will increase their purchases of flowers from 25 dozens to 30 dozens. In panel B, the demand curve shifts to the left from D1 to D2. At price Php300 per dozen, consumers will lessen their purchases from 30 dozens to 25 dozens.

5. **PRICE OF RELATED GOODS** is one of non-price factor that affect the demand curve is the price of related commodity which includes **substitute goods** and **complementary goods.**

Substitute Goods are those commodities which they perform the same function and can satisfy the same needs and wants. These goods are used to take the place of another good. Example of these are ballpen or pencil, sugar or honey, coffee or tea, and omnibus services or jeep services. Meanwhile, **complimentary goods** are goods in which you consume it hand on hand. These goods are consumed together. Examples of these are coffee and sugar, sock and shoes, belt and pants, hospital services and doctor's services, and DVD and DVD player.

Case No. 2.6

The fare for omnibus services increase by Php3.00 each. What will happen to the demand of jeepney services?

If we're going to analyse, omnibus services and jeepney services perform the same function therefore, omnibus services is a substitute to jeep services. If the price of omnibus services increases, according to the law of demand, quantity demanded for omnibus services will decrease and consumers of omnibus services will shift to jeepney services. Figure 2.7 shows the change that occurs.

As stated in the previous section, if the price of omnibus services increases, the quantity demanded for omnibus services will decrease. The question is what will the consumer use if they will not render the service of omnibus?

Figure 2.7

Changes if Demand Curve of Omnibus and Jeep Services

Figure 2.7 panel A shows the change in demand curve of omnibus services as its price increases. Because the change that occurs is brought by the price of omnibus, from point A, the quantity demanded for omnibus services declines from 15 to 10 and move to point B as its price increases from Php20 to Php 40.

Figure 2.7 panel B shows the changes in demand curve in jeepney services brought by the changes in demand curve in omnibus services. Because the price of jeepney services did not change, therefore, the demand for jeepney services increases and the demand curve shifts to the right. This is shown in the shift of demand curve from D1 to D2 thus, the quantity demanded for jeepney services increases from 10 to 15.

SUPPLY

Supply is the relationship between price and quantity supplied. It is the quantity of goods and services that the sellers are willing and able to sell or produce. Supply has positive relationship with price. This is stated in the law of supply.

Law of Supply states that "all other things remaining constant (Ceteris paribus), price and quantity supplied are directly proportional." There is a positive relationship between price and quantity supplied. The same with demand, it can be expressed in three forms.

1.Supply Schedule is a tabular presentation of supply showing the price and quantity supplied of a particular good.

SUPPLY SCHEDULE OF CLOTH (PER YARD)

PRICE	QS
500	1000
400	800
350	600
200	400
100	200

Table 2.2

Supply Schedule for the Commodity

1.Supply Curve is the graphical presentation of the supply schedule. This is upward sloping to the right showing a direct relationship between price and quantity supplied. Therefore, when price increases in the Y axis, its quantity supplied also increases in the X axis.

In Figure 2.9 as price increases from Php100 to Php500, its quantity supplied also increases from 200 to 1,000 yards of cloth. Sellers are more willing to sell if the price is low.

2. Supply Function is a mathematical model in showing the relationship between price and quantity supplied. From the equation 2.2, the sign of the coefficient of price is positive which denotes its relationship to quantity.

$$Qs = 5 + 3P$$

CHANGES IN SUPPLY BROUGHT BY PRICE FACTOR

Movement along the Supply Curve/Change in Quantity Supplied

This only occur when the price of the commodity changes.

Case No. 2.8

The price of corn in the market increases. What will happen to supply of corn? The answer is shown in figure.

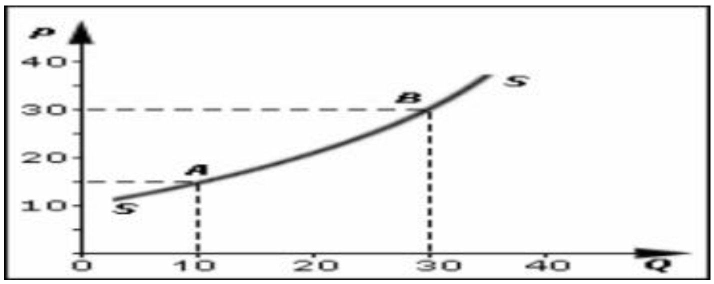


Figure 2.10

Change in supply Curve of Corn as Its Price Increases.

Figure 2.10 presents the movement along the supply curve as the price of the corn increases. This connotes that as the price of corn increases, the sellers are more willing to sell corn. As the price increases from Php30 to Php40 per kilo of corn, sellers are more willing to sell corn. The quantity supplied of corn increases from 30kilos to 40 kilos of corn. This show the direct relationship between price and quantity supplied. The movement of supply curve from Point A to Point B shows a movement along the supply curve or change in quantity supplied brought by price factor.

CHANGES IN SUPPLY BROUGHT BY NON-PRICE FACTORS

Shift of the Supply Curve/Change in Supply

- Shift of the supply curve occurs when the non-price factors changed. The following are the non-price factors that affect the supply curve.

1. **S**ubsidies and Taxes
2. **T**echnology
3. **O**ther Goods
4. **N**umber of Sellers/Producers
5. **E**xpectations
6. **R**esource Cost/Price

For you to easily memorize the determinants of supply curve, just remember the acronym **STONER.**

1. **SUBSIDIES AND TAXES/GOVERNMENT ACTION**

Refers to the power of the government to intervene in the market that will affect the supply. Some of the government actions are the **subsidies, taxes** and **regulation.**

- **Subsidies** are the incentive given by the government to motive the producer to provide more products in the market. If government imposes subsidies, then the supply for commodity will increase and supply curve shift to the right.

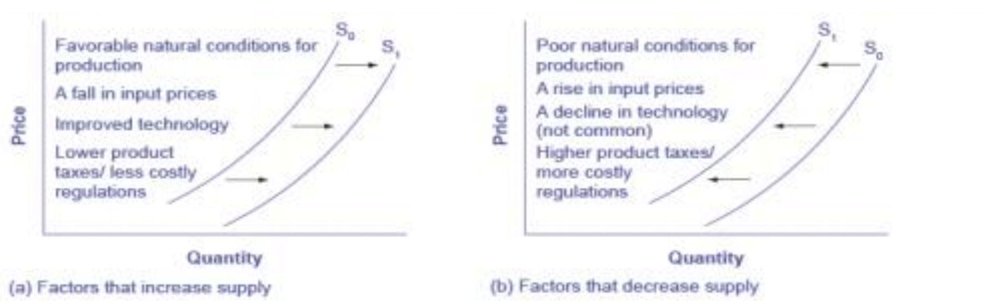
- **Taxes** are the power of the government to impose a certain percentage to persons and property. It is said that it is universal because the state can impose tax. It should be paid compulsory. If the government imposes higher tax to certain product or business, the seller and producer are less likely to sell or produce the product therefore, supply curve will shift to the left.

- **Regulations** are the power of the government to impose some rules to control some political, administrative and economic activity done within the vicinity of the state. Examples of these are permits and ordinance before putting up a business. Most of the time, this is one of the legal barriers that a new entrants may encounter. Increasing the control of regulations, or its strict implementation, the less likely the firms want to enter or to produce a commodity. In this case, supply curve will shift to the left.

2. **TECHNOLOGY** refers to the machine, methods and processes to improve the production of the firm which leads to productivity. With the use of high technology, the producers are more motivated to produce and this will cause an increase of supply. In contrast, an outmoded technology does not motivate a producer to produce which will lead to a decrease in the supply of a particular good.

<u>Case No. 2.9</u>

Alvin can only produce 100 units of bread a day but because he acquired machine, he can produce 200 units of bread a day. What is the change that occurs in the supply curve? How about if an earthquake comes and destroys the bakery and the machine?



PANEL A – With Machine PANEL B – Without Machine

Figure 2.11

Change in Supply Curve of Bread based on Productivity

Figure 2.11 shows the change in supply curve as productivity changes. In Panel A, the supply curve shifts to the right as Alvin acquire machine. This is shown in the movement of supply curve from S1 to S2. The price did not change but the supply of bread increases from 100 to 200 units. In contrast, as machine and factory (bakery) were destroyed by an earthquake, productivity declines and supply will decline too. Therefore, supply curve will shift to the left. Supply curve shift from S1 to S2 and the quantity supplied decrease from 200 to 50 units. This is presented in Figure 2.11, panel B.

3. **OTHER GOODS.** If the producers noticed that producing other goods will give them more profit, therefore, the supply for the goods they are produced are present will decline.

4. **NUMBER OF SELLERS**. Refers to the number of sellers in the industry. Industry refers to a group of firms selling the same product. Remember that supply refers to all firms producing the product. If the number of firms increases, then more goods will be produced at each price and supply will increase. Therefore, supply curve will shift to the right. A decline in the number of firms would shift the supply curve to the left.

5. **EXPECTATION** is the anticipation of the firms about the price of commodity they are selling. If firms expect that the price of goods they produce will increase in the future, then they will hold off selling at least part of the production until the price rises. Expectation of future price increases tends to reduce the supply. Conversely, expectation of future price decreases tends to increase supply.

6. **RESOURCE PRICE.** Refers to the raw materials of factors of production needed to produce a certain product. It also includes the price of those raw materials. If the raw materials are available or abundant, most probably, the supply of goods will increase. If the raw materials are not available or inadequate, supply of goods will decrease. Likewise, an increase in the price of raw materials will decrease in its price will increase in supply.

<u>Case No. 2.10</u>

The price of flour increases. What will happen to the supply of bread?

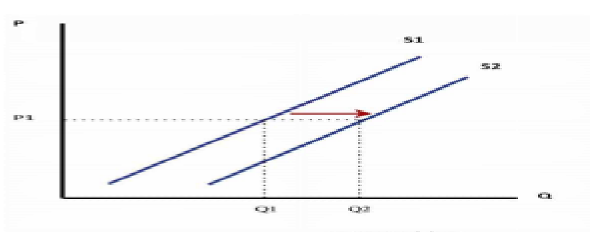


Figure 2.12

Change in Supply Curve of Bread based on Inputs

We can glean in figure 2.12 that supply curve shifts to the left from S1 to S2 brought by the increase in the price of flour. The supply of bread will decrease due to increase in the price of flour. Remember that we are under the assumption of cetris paribus, holding other variable constant, such as budget for production.

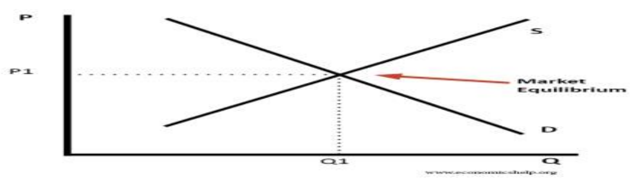
DEMAND AND SUPPLY EQUILIBRIUM

- **Definition of Market Equilibrium** – A situation where for a particular good supply = demand. When the market is in equilibrium, there is no tendency for prices to change. We say the market-clearing price has been achieved.
- A market occurs where buyers and sellers meet to exchange money for goods.
- The price mechanism refers to how supply and demand interact to set the market price and amount of goods sold.
- At most prices, planned demand does not equal planned supply. This is a state of disequilibrium because there is either a shortage or surplus and firms have an incentive to change the price.

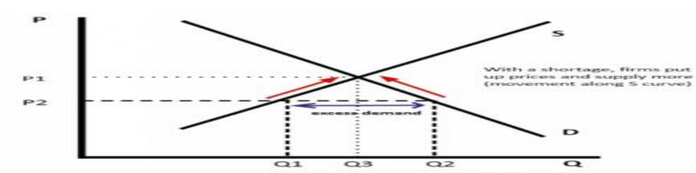
Market Equilibrium

Market equilibrium can be shown using supply and demand diagrams

In the diagram below, the equilibrium price is P1. The equilibrium quantity is Q1.



If price is below the equilibrium



- In the above diagram, price (P2) is below the equilibrium. At this price, demand would be greater than the supply. Therefore there is a shortage of (Q2 – Q1)
- If there is a shortage, firms will put up prices and supply more. As price rises, there will be a movement along the demand curve and less will be demanded.
- Therefore the price will rise to P1 until there is no shortage and supply = demand.

Surplus and shortage:

- If the market price is above the equilibrium price, quantity supplied is greater than quantity demanded, creating a surplus. Market price will fall.

Example: if you are the producer, you have a lot of excess inventory that cannot sell. Will you put them on sale? It is most likely yes. Once you lower the price of your product, your product's quantity demanded will rise until equilibrium is reached. Therefore, surplus drives price down.

- If the market price is below the equilibrium price, quantity supplied is less than quantity demanded, creating a shortage. The market is not clear. It is in shortage. Market price will rise because of this shortage.

Example: if you are the producer, your product is always out of stock. Will you raise the price to make more profit? Most for-profit firms will say yes. Once you raise the price of your product, your product's quantity demanded will drop until equilibrium is reached. Therefore, shortage drives price up.

- If a surplus exist, price must fall in order to entice additional quantity demanded and reduce quantity supplied until the surplus is eliminated. If a shortage exists, price must rise in order to entice additional supply and reduce quantity demanded until the shortage is eliminated.

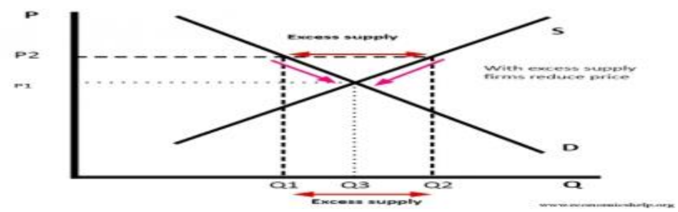
Schedule of Demand and Supply of Chicken

Points	**Price in Peso/Kilo**	**Quantity Demand**	**Quantity Supply**	**Situation**
A	70	100	40	Shortage
B	75	90	50	Shortage
C	80	80	60	Shortage
D	**85**	**70**	**70**	**Equilibrium**
E	90	60	80	Surplus
F	100	50	90	Surplus

As shown in the Table, there are 100 consumers who are willing to buy at P70.00 per kilo of chicken while there are only 40 sellers who are willing to sell at the said price. More demand than supply means a shortage of chicken in the market. To be able to meet the demand of the chicken, buyers of the chicken has to vary from P70.00 to P100.00 per kilo. It is at price of P85.00/kilo that the quantity demanded and quantity supply agreed; therefore, point D is the equilibrium point. The equilibrium price and equilibrium quantity of a commodity are determined by the demand and supply of the market. The equilibrium price is the price at which the quantity of the goods are purchased at a given price by the consumer. Therefore, the point where the willingness of the buyer to buy and the willingness of the seller to sell meet at a given price is actually the **Law of Demand and Supply**. The producers sell at equal quantity where the consumers buy at the same equal quantity to an agreed price.

The intersection of the demand and supply curve is the point of equilibrium and the price at which it dictates is the equilibrium price.

If price is above the equilibrium



If price was at P2, this is above the equilibrium of P1. At the price of P2, then supply (Q2) would be greater than demand (Q1) and therefore there is too much supply. There is a surplus. (Q2-Q1)

- Therefore firms would reduce price and supply less. This would encourage more demand and therefore the surplus will be eliminated. The new market equilibrium will be at Q3 and P1.

Government Intervention

Government regulations will create surpluses and shortages in the market. When a **price ceiling** is set, there will be a **shortage**. When there is a **price floor**, there will be a **surplus**.

Price Floor: is legally imposed **minimum** price on the market. Transactions below this price is prohibited. Policy makers set floor price above the market equilibrium price which they believed is too low. Price floors are most often placed on markets for goods that are an important source of income for the sellers, such as labor market. Price floor generate surpluses on the market.

•Example: minimum wage.

Price Ceiling: is legally imposed **maximum** price on the market. Transactions above this price is prohibited. Policy makers set ceiling price below the market equilibrium price which they believed is too high. Intention of price ceiling is keeping stuff affordable for poor people. Price ceiling generates shortages on the market. •Example: Rent control.

CHAPTER 2 EXERCISES

Name: ____ **Score: _________________**

Year/Course/Section: ____________________________ **Schedule: ______________**

I. Enumeration: State what is being asked.

1. Give at least Five Factors that Influence Demand.

A.
B.

C.

D.

E.

2. Give at least Five Factors that Influence Supply.

A.

B.

C.

D.

E.

3. State the Law of Demand.

____
____
____
____
____

4.State the Law of Supply.

____
____

____
____
____

I. ANALYSIS:

Demand and Supply of Hamburger/Week

PRICE	QTY. DEMAND	QTY. SUPPLY
10	500	100
12	400	200
18	300	300
20	200	400
22	100	500

A shortage exist at price ______________
A surplus exist at price _______________
The equilibrium price is ______________
The equilibrium quantity is ____________
If the price is P20.00 there would be (shortage/surplus) of hamburger.
As price changes from P20.00 to P22.00 there has been change in Price D ______ QD _______________ Price S ____________ QS ____________

MODULE 3- READING

CHAPTER III

ELASTICITIES OF DEMAND AND SUPPLY

OBJECTIVES:

- To know the meaning of Elasticity
- To differentiate the different degree of Elasticity
- To understand the different types of Elasticity; and
- To be able to learn the two methods of Elasticity

ELASTICITY is the degree to which a demand or supply curve reacts to a change in the price and other determinants. Elasticity varies among products because some products may be more essential to the consumer. Products that are necessities are more insensitive to price changes because consumers would continue buying these products despite price increases. Conversely, a price increase of a good or service that is considered less of a necessity will deter more consumers because the opportunity cost of buying the products will become too high.

Different Degree of Elasticity

1. **Elastic** – Demand or Supply is elastic when there is a greater change in quantity demanded or supply. In mathematical equation it is always greater than one.

   a. **Perfectly elastic demand/supply-** occurs when there is infinite change in quantity demanded/quantity supply.

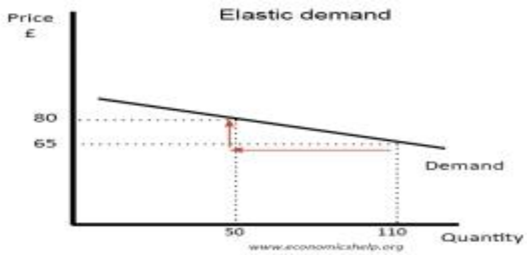
2. **Inelastic** – Demand or supply is inelastic when there is a lesser change in quantity demanded or supply. In mathematical equation it is always less than one.

   a . Perfectly inelastic demand/supply – occurs when there is almost no change in quantity demanded/quantity supply because there is no close substitute to the product.

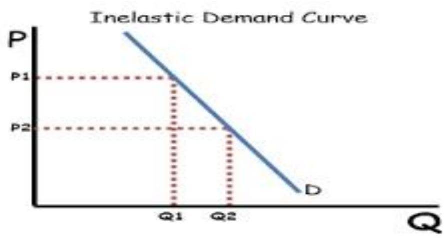
3. **Unitary** – Demand or supply is unitary when there is an equal change in quantity demanded or supply. In mathematical equation it is equal to one.

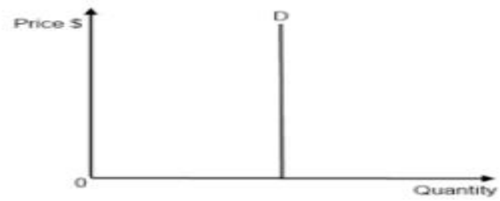
Demand Elasticity Figure 1

Elasticity = (% change in quantity / % change in price)



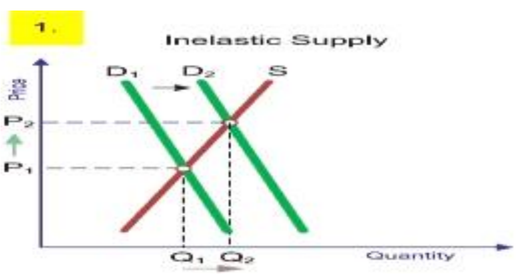
Perfectly elastic demand

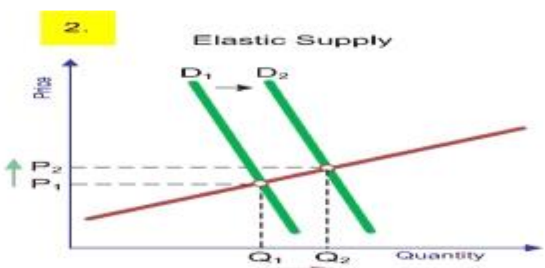


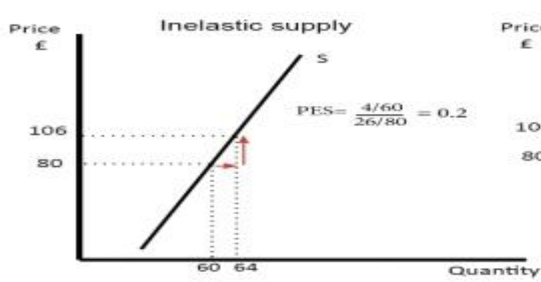


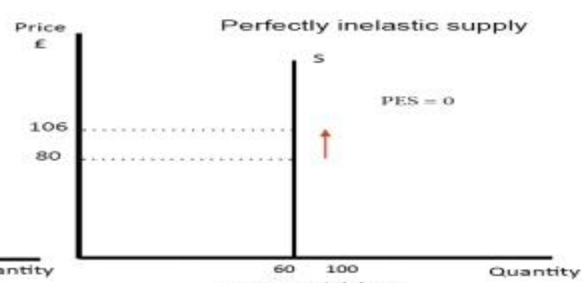
Perfectly inelastic demand

Supply Elasticity Figure 2









Various factors which affect the elasticity of demand of a commodity are:

1. Nature of commodity:

Elasticity of demand of a commodity is influenced by its nature. A commodity for a person may be a necessity, a comfort or a luxury.

i. When a commodity is a necessity like food grains, vegetables, medicines, etc., its demand is generally inelastic as it is required for human survival and its demand does not fluctuate much with change in price.

ii. When a commodity is a comfort like fan, refrigerator, etc., its demand is generally elastic as consumer can postpone its consumption.

2. Availability of substitutes:

Demand for a commodity with large number of substitutes will be more elastic. The reason is that even a small rise in its prices will induce the buyers to go for its substitutes. For example, a rise in the price of Pepsi encourages buyers to buy Coke and vice-versa.

Thus, availability of close substitutes makes the demand sensitive to change in the prices. On the other hand, commodities with few or no substitutes like wheat and salt have less price elasticity of demand.

3. Income Level:

Elasticity of demand for any commodity is generally less for higher income level groups in comparison to people with low incomes. It happens because rich people are not influenced much by changes in the price of goods. But, poor people are highly affected by increase or decrease in the price of goods. As a result, demand for lower income group is highly elastic.

4. Level of price:

Level of price also affects the price elasticity of demand. Costly goods like laptop, Plasma TV, etc. have highly elastic demand as their demand is very sensitive to changes in their prices. However, demand for inexpensive goods like needle, match box, etc. is inelastic as change in prices of such goods do not change their demand by a considerable amount.

5. Postponement of Consumption:

Commodities like biscuits, soft drinks, etc. whose demand is not urgent, have highly elastic demand as their consumption can be postponed in case of an increase in their prices. However, commodities with urgent demand like life saving drugs, have inelastic demand because of their immediate requirement.

6. Number of Uses:

If the commodity under consideration has several uses, then its demand will be elastic. When price of such a commodity increases, then it is generally put to only more urgent uses and, as a result, its demand falls. When the prices fall, then it is used for satisfying even less urgent needs and demand rises.

For example, electricity is a multiple-use commodity. Fall in its price will result in substantial increase in its demand, particularly in those uses (like AC, Heat convector, etc.), where it was not employed formerly due to its high price. On the other hand, a commodity with no or few alternative uses has less elastic demand.

7. Share in Total Expenditure:

Proportion of consumer's income that is spent on a particular commodity also influences the elasticity of demand for it. Greater the proportion of income spent on the commodity, more is the elasticity of demand for it and vice-versa.

Demand for goods like salt, needle, soap, match box, etc. tends to be inelastic as consumers spend a small proportion of their income on such goods. When prices of such goods change, consumers continue to purchase almost the same quantity of these goods. However, if the proportion of income spent on a commodity is large, then demand for such a commodity will be elastic.

8. Time Period:

Price elasticity of demand is always related to a period of time. It can be a day, a week, a month, a year or a period of several years. Elasticity of demand varies directly with the time period. Demand is generally inelastic in the short period.

It happens because consumers find it difficult to change their habits, in the short period, in order to respond to a change in the price of the given commodity. However, demand is more elastic in long rim as it is comparatively easier to shift to other substitutes, if the price of the given commodity rises.

Types of Elasticity

1 . Price Elasticity – refers to the type of elasticity that deals with the degree of responsiveness of people when there are changes in prices.

Example: When there is a change in price whether increase or decrease people reacted in the situation by buying/selling less or buying/selling more or not buying/selling at all.

The concept of responsiveness is presented in terms of percentage change. Choosing two points on the demand/supply curve and comparing the percentage change in the quantities and the price on those two points compute its value. Thus:

$$EP = \frac{\Delta Qty/Qty}{\Delta P/P} = \frac{\text{\% change in qty. demanded}}{\text{\% change in price}}$$

If coefficient of elasticity is:

> 1 = elastic

< 1 = inelastic

= 1 = unitary

2 . Income Elasticity – refers to the type of elasticity that deals with te degree of responsiveness of people when there are changes in income.

Example: When Juan dela Cruz has increase in his salary, his consumption will differ in buying more goods that resulted to an increase in his purchasing power.

It expresses the percentage change in demand/supply compared to percentage change in income.

$$EY = \frac{\Delta QD/QD}{\Delta Y/Y} \; / \; \frac{\Delta QS/QS}{\Delta Y/Y}$$

The coefficient of income elasticity may have a positive or negative sign. Positive sign for normal goods when there is an increase in income and negative sign for inferior goods when income falls.

Income elasticity of demand measures the relationship between a change in quantity demanded for good X and a change in real income.

The formula for calculating income elasticity is:

% Change in demand divided by the % change in income

$$Ey = \frac{\Delta Qd/Qd}{\Delta Y \div Y} = \frac{D2\text{-}D1/D1}{Y2\text{-}Y1/Y1}$$

Example: An increase in Joey's income from Php600 to Php850 causes his demand for Good Z to change from 5 to 8 kilos.

$$Ey = \frac{8 - 5/5}{850 - 600/600} \quad \frac{.6}{.42} \quad ey = 1.43 \quad \text{Normal good}$$

An increase in Mary's income from Php18000/month to Php20000/month cause her demand for Good B to change from 50 to 20 units per month

$$\frac{20 - 50 / 50}{20{,}000 - 18000/18000} \qquad \frac{(.6)}{.11} \qquad ey = (5.45) \text{ Inferior good}$$

Types of Goods Affected by Income Elasticity

1 . Normal Goods

Normal goods have a **positive income elasticity of demand** so as consumers' income rises, more is demanded at each price, and there is an outward shift of the demand curve.

1.1 **Normal necessities** have an income elasticity of demand of **between 0 and +1** for example, if income increases by 10% and the demand for fresh fruit increases by 4% then the income elasticity is +0.4. Demand is rising less than proportionately to the income.

2. **Luxury Goods and Services** have an income elasticity of > +1, if the demand rises more than proportionate to a change in income for example an 8% increase in income might lead to a 10% rise in the demand for new appliances. The income elasticity of demand in this example is +1.25.

Inferior Goods

3.1 Inferior goods have a negative income elasticity of demand, meaning that demand falls as income rise. Typically inferior goods or services exist where superior goods are available if the consumer has the money to buy it.

- Inferior Goods : Galunggong, Tuyo
- Superior Goods : Lapu-lapu
- Carinderia : Restaurants

Cross Price Elasticity of Demand

Cross Price Elasticity of Demand (XED) measures the responsiveness of demand for one good to the change in the price of another good. It is the ratio of the percentage change in quantity demanded of Good X to the percentage change in the price of Good Y.

For businesses, XED is an important strategic tool. This elasticity measure can help determine whether or not it is a good move to increase or decrease selling prices, or to substitute one product for another to generate greater revenues.

There are three types of cross-price elasticity of demand: substitute goods, complementary goods, and unrelated products.

Types of Cross Elasticity of Demand

Cross Price Elasticity of Demand for Substitutes

When the cross-price elasticity of demand for product A relative to a change in the price of product B is positive, it means that the quantity demanded of product A has increased in response to a rise in the price of product B. Many consumers have switched from consuming product B to consuming product A. This implies that most consumers perceive products A and B as substitutes that satisfy similar preferences.

Substitutes will always have a positive Cross Price Elasticity or greater than zero.

Cross Price Elasticity of Demand for Complements

When the cross elasticity of demand for product A relative to a change in the price of product B is negative, it means that the quantity demanded of A has decreased relative to a rise in the price of product B. Even though the price of product A is unchanged, many consumers still decreased their consumption of it because the price increase for product B made consuming these products together more expensive. This implies that most consumers perceive products A and B as complements that are more enjoyable consumed together than consumed separately.

Complements will always have a negative Cross Price Elasticity or less than zero.

Cross Elasticity of Demand for Unrelated

These are goods that show no relationship in consumer consumption patterns. Price changes in one product don't affect the quantity consumed of the other product.

Worked Example: Cross-Price Elasticity of Demand

Calculating Cross-Price Elasticity of Demand

This worked example asks you to compute two types of demand elasticities and then to draw conclusions from the results. The initial price and quantity of widgets demanded is (P1 = 12, Q1 = 8). The subsequent price and quantity is (P2 = 9, Q2 = 10). This is all the information needed to compute the price elasticity of demand.

The price elasticity of demand is defined as follows:

Price Elasticity of Demand = $\frac{Percent\,Change\,in\,Quantity}{Percent\,Change\,in\,Price}$

From the midpoint formula, we know that:

Percent change in quantity= $\frac{Q1-Q2}{(Q2-Q1)/2}$ x 100 = $\frac{10-8}{(10-8)/2}$ x 100 = $\frac{2}{9}$ x 100 = 22.2%

And:

$$\text{Percent Change in Price} = \frac{P2-P1}{(P2-P1)/2} \text{ x } 100 = \frac{9-12}{(9+12)/2} \text{ x} 100 = \frac{-3}{10.5} \text{ x } 100 = -28.6\%$$

Therefore:

$$\text{Price Elasticity of Demand} = \frac{22.2\%}{-28.6\%} = -0.77$$

Since the elasticity is less than 1 (in absolute value), we can say that the price elasticity of demand for widgets is in the inelastic range.

The cross-price elasticity of demand is computed similarly:

$$\text{Cross-Price Elasticity of Demand} = \frac{Percent\,change\,in\,quantity\,of\,sprokets\,demanded}{Percent\,change\,in\,price\,of\,widgets}$$

The initial quantity of sprockets demanded is 9 and the subsequent quantity demanded is 10 (Q1 = 9, Q2 = 10).

Using the midpoint formula, we can calculate the percent change in the quantity of sprockets demanded:

$$\text{Percent Change in Quantity} = \frac{Q2-Q1}{(Q2-Q1)/2} \text{ x } 100 = \frac{10-9}{(10-9)/2} \text{ x } 100 = \frac{1}{9.5} \text{ x } 100 = 10.5\%$$

The percent change in the quantity of sprockets demanded is 10.5%.

The percent change in the price of widgets is the same as above, or -28.6%.

Therefore:

$$\text{Cross-Price Elasticity of Demand} = \frac{10.5\%}{-28.6\%} = -0.37$$

Because the cross-price elasticity is negative, we can conclude that widgets and sprockets are complementary goods. Intuitively, when the price of widgets goes down, consumers purchase more widgets. Because they're purchasing more widgets, they purchase more sprockets.

CHAPTER 3 EXERCISES

Name: ____ **Score: _________________**

Year/Course/Section: ____________________________ **Schedule: _____________**

ASSIGNMENT AND ASSESSMENT

I. IDENTIFICATION:

________________________ 1. The percentage change in the quantity demanded of one good compared to a percentage change in the price of a related good.

________________________ 2. Goods the demand for which tends to decrease when income increases.

________________________ 3. The absolute value of elasticity.

________________________ 4. Goods which gain importance when income increases.

________________________ 5. Degree of elasticity when change in price results to a more that proportionate change in quantity demanded.

________________________ 6. The percentage change in quantity demanded compared to a percentage change in income.

________________________ 7. The responsiveness of demand or supply to a change in determinants.

________________________ 8. The percentage change in quantity demanded compared to a percentage change in its price.

________________________ 9. Goods which are used to take place to another goods.

________________________10. Goods, the demand for which decreases when income increases.

________________________11. Degree of price elasticity when the percentage change in quantity demanded is lesser than the percentage change in price.

________________________12. Goods which are used together.

________________________13. Degree of price elasticity when its coefficient is one.

_______________________14. Occurs when there is infinite change in quantity demanded/quantity supply.

_______________________15. Type of elasticity that deals with percentage change in the demand for one good due to another change in the demand for another like in complimentary and substitute goods.

MODULE 4 - READING

CHAPTER IV

THEORY OF CONSUMER BEHAVIOR

Learning Objectives

- Explain the concept of utility and the basic assumptions underlying consumer preferences.
- Explain the equilibrium condition for an individual consumer to be maximizing utility subject to a budget constraint.
- Use indifference curves to derive a demand curve for an individual consumer.
- Identify the substitution, income, and total effects of a change in the price of a good.
- Explain why demand curves are downward sloping.

" Choices lies on what do we want and what can we afford…"

In day to day living, we always make choice especially when we consume product. The goods and services that we consume is basically the one that can satisfy us. Satisfaction is much subjected concept and no one can say that the satisfaction that I gain is the same as yours.

Basically, demand first comes up with satisfaction. Satisfaction before has no measurement but in order to study the level of satisfaction, economist coined a measurement on this, it is called utility.

Utility as Satisfaction

Level of satisfaction is measured as **utility** and the unit of satisfaction is called **utils**. Remember that the higher the utils, the higher the level of satisfaction.

Utility can be measured in two methods, the ordinal and cardinal method. **Ordinal method** is done when an individual ranks the utility for commodity. For example, Andrew ranks apple, orange and mango according to level of satisfaction he derive in consuming 1 unit of fruit. Then using ordinal method Andrew will answer in this way.

I prefer apple than orange but I prefer orange than mango. From this, Andrew ranks the fruit as apples ranks 1, orange ranks 2 and mango as rank 3.

Cardinal method is the process in which individual give the intensity of utils he derive in 1 unit of goods. In above example, Andrew may rate apple as 7 utils while orange 4 utils and mango has 1 util.

Most of the time, the individual use ordinal method but for the purpose of studying consumer behaviour, economist often ask the cardinal value of utility of individual. For example, you ask the level of satisfaction in consuming water since water is free. Considering that you just finish jogging for 3 hours. Table 4.1 shows the total utility and marginal utility for every glass of water you drink.

Glass of H20	**Total Utility** **(TU)**	**Marginal Utility** **(MU)**
0	0	-
1	5	5
2	9	4
3	12	3
4	14	2
5	14	0
6	13	-1
7	10	-3

Table 4.1

Total Utility Marginal Utility for Glass of Water

As you can noticed, total utility for glass of water increases. When you drink 1 glass of water, your level of satisfaction is 5, but when you drink additional glass, your satisfaction increases to 9 and so on.

However, if we're going to look for the value of marginal utility, it declines as you consume additional glass of water. **Marginal utility** is additional or extra utils the individual gains when he or she consumes additional 1 unit of commodity. From Table 4.1, when you drink 1 glass of water marginal utility is 5, when you drink another glass of water, the marginal utility is 4. But when you drink the 5th glass of water, your marginal utility is equal to 0 and when you drink the 6th glass, MU is equal to -1. When you graph your TU and MU:

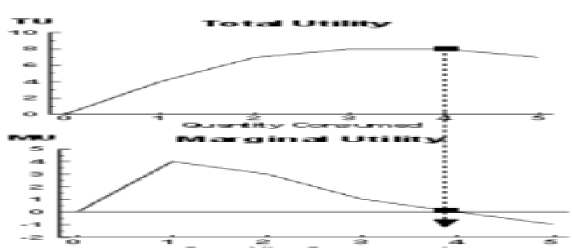


Figure 4.1

Total Utility and Marginal Utility in Consuming Glass of Water

From Figure 4.1, we can gleaned that when TU curve is on its peak, MU intersects the X-axis which means MU is equal to zero. The graph of MU is downward sloping. At 5th glass of water, you already get the saturation point. **Saturation point** is the point where your total utility curve is on its peak and the marginal utility is equal to 0.

In this instance, we can observe the law of diminishing marginal utility**.** **Law of Diminishing Marginal Utility** states that as we consume more and more units of goods, the marginal utility decreases.

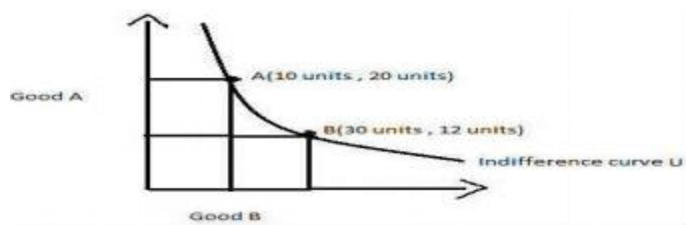
INDIFFERENCE CURVE

Indifference curve is a tool which shows the different combination of goods and services that an individual consumes that yields the same level of satisfaction or utility. Indifference curve has four assumptions:

There are only two goods available in the market.
Indifference curve bows against (Convex) the origin.
Any point along the curve utilizes the same level of satisfaction.
Indifference curve never intersects.

Figure 4.2 is an example of indifference curve

Description: Graphically, the indifference curve is drawn as a downward sloping convex to the origin. The graph shows a combination of two goods that the consumer consumes.



The above diagram shows the U indifference curve showing bundles of goods A and B. To the consumer, bundle A and B are the same as both of them give him the equal satisfaction. In other words, point A gives as much utility as point B to the individual. The consumer will be satisfied at any point along the curve assuming that other things are constant.

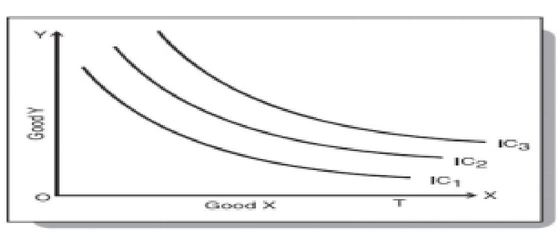


Fig. 2 : Indifference Map

Figure 4.2 (b)

INDIFFERENCE MAP

Indifference Map is a set or collection of indifference curves which represents various levels of satisfaction or utility.

Indifference curve lies above and to the right of another indicates a higher level of satisfaction.

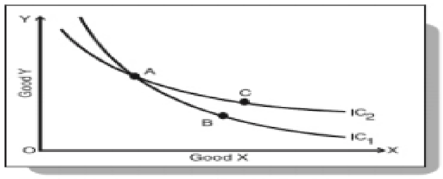


Fig. 3 : Intersecting Indifference Curves

If indifference curves IC1 and IC2 intersects, one of the assumption (i.e. No.4) of consumer theory is violated. Based to this diagram, the consumer should be indifferent among combination of goods A, B and C. Yet B should be preferred to A because B has more of both goods.

BUDGET CONSTRAINTS

Budget Constraints refers to the constraints that consumer face as a result of limited incomes.

Budget Line refers to all combinations of goods for which the total amount of money spent is equal to income.

As we all know, there is no free in this world. All commodities have its price. Therefore an individual cannot easily choose among the combination of goods that lies along the indifference curve. Therefore, we may say that we are constraints with our budget.

In order to determine the combination of goods that will satisfy our utility and budget, economist use the budget line. **Budget line** is the line that represents combination of goods that can be purchased by your income.

Figure 4.3 shows the budget line of an individual. If individual has Php1,000 therefore, at point A, individual can buy 10 units of food and 4 units of clothes. On the other hand, using Php1,000 as well, individual can purchase at point B where he can buy 4 units of food and 12 units of clothes.

COMBINATION OF GOODS X AND Y AND THE BUDGET LINE

	FOOD (X)	CLOTHING (Y)	TOTAL
A	0	50	Php1,000
B	20	40	Php1,000
C	40	30	Php1,000
D	60	20	Php1,000
E	80	10	Php1,000
F	100	0	Php1,000

Table 4.1

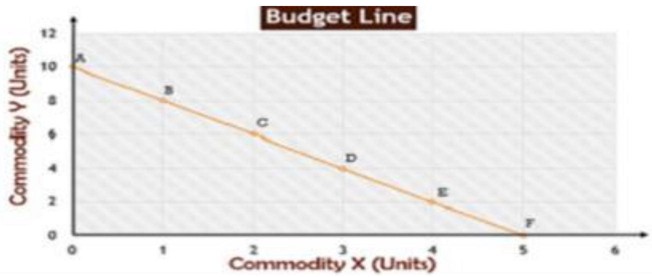


Figure 4.3

Budget Line

Figure 4.3 shows the budget line associated with the combination of the good X and Y given in the table 4.1. As you can see, giving up of a unit clothing saves Php20 and buying two units of costs Php10, the amount of clothing given up for food along the budget line must be the same everywhere, Therefore, the budget line is a straight line from point A to point F, in his scenario, the budget line is given by the equation F+20(c) = Php100.

CONSUMER EQUILIBRIUM

Consumer equilibrium is the point where budget line tangent to the indifference curve. In real sense, it is a combination of goods in which the individual optimize his utility and budget.

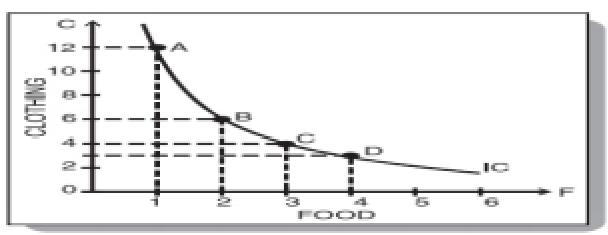


Fig. 1 : A Consumer's Indifference Curve

Figure 4.4

Consumer Equilibrium

Referring to table 3.2, the consumer equilibrium can be found at point C. Therefore, individual can consume 2 units of food and 6 units of clothes which also satisfy his income.

Mathematically, consumer equilibrium can be expressed in terms of:

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$$

Or

$$\frac{MU_x}{MU_y} = \frac{P_x}{P_y}$$

Where MUx is the marginal utility for first commodity, MUy is the marginal utility for second commodity, Px is price of first commodity and Py is the price of second commodity.

Let us say that Cynthia wants to buy Pizza and render Video Rentals. Suppose that she has a monthly budget for two commodities of Php3.00, each pizza cost Php6.00 and video rentals of Php36.00.

Availing the Video Rentals

Q	TU	MU	MU/P
0	0		
1	200	200	33.33
2	290	90	15
3	370	80	13.33
4	440	70	11.67
5	500	60	10
6	550	50	8.33
7	590	40	6.67

Consumption of Pizza

Q	TU	MU	MU/P
0	0		
1	250	250	83.33
2	295	45	15
3	335	40	13.33
4	370	35	11.67
5	400	30	10
6	425	25	8.33
7	445	20	6.67

In this case, quantity 2-6 for both commodities satisfy the condition of consume equilibrium. But to determine which combination she can afford, then you need to multiply the combination of goods to its price. In this case the point where Cynthia will consume 4 units of pizza and 4 movies theatre, In computation:

1 = PxX + PyY

36 = (Php6 x 4) + (Php3X)

Php36.00 = Php36.00

CHAPTER 4 EXERCISES

Name: ____ **Score:** _________________

Year/Course/Section: ____________________________ **Schedule:** ______________

Test I. Identification

Direction: Identify the following statements. Write your answer on the space provided for.

___________________________ 1. The unit of satisfaction.
___________________________ 2. It is the level of satisfaction.
___________________________ 3. It is additional or extra utils the individual gains when he or she consumes additional 1 unit of commodity.
___________________________ 4. It is a tool which shows the different combination goods and services that an individual consumes that yields the same level of satisfaction of utility.
___________________________ 5. It is the line that represents combination of goods that can be purchased by your income.

II . During month-end, Homer loves to drink beer and eat crackers as the side dish. The units of beer are express in glass while crackers are express in packs. The price of crackers in Php1.50 per pack while the price of beer is Php3.00 per glass. His budget every month for the two commodities is Php18.00.

Packs of Crackers	**TU**	**MU**	**MU/P**
0	0		
1	10		
2	18		
3	24		
4	28		
5	31		
6	33		
Glass of Beer	**TU**	**MU**	**MU/P**
0	0		
2	18		
4	33		
6	45		
8	54		
10	60		
0	0		

1 . Compute the MU and MU/P for each point for both commodities.
2. How many glass of beer and packs of crackers should Homer consume to attain the consumer equilibrium? Explain your answer.

MODULE 5 - READING

CHAPTER V

THEORY OF PRODUCTION AND COST

OBJECTIVES:

- To explain the input output relationship
- To describe the Importance of Law of Diminishing Return
- To analyse the Different Cost in Production; and
- To know the meaning of Economies and Diseconomies of Scale.

What is Theory of Production?

The theory involves some of the most fundamental principles of economics. It is an effort to explain the principle, by which a business firm decides how much of each commodity that it sells, it will produce and how much of labour, raw material, fixed capital good, etc., it will use.

This also includes the relationship between the prices of commodities and the wages or rents of the productive factors used to produce them. On the one hand, it explains the relationship between the prices of commodities and productive factors, on the other, the quantities of these commodities and productive factors that are produced or used.

Relativity of Production and Cost

A business firm buys economic resources called inputs, and sells the goods it produces called outputs. The factors of production used by a firm in the production of a good or a service are generally referred to as inputs. A firm has to pay for the inputs it needs. Inputs generate costs and generate output.

To elaborate more, a *factor of production that cannot be changed in the short-run is called* ***Fixed Input*** *whereas;* a *factor of production that depends upon the level of production is called* ***Variable Input****. Variable inputs change depending upon how much we choose to produce.*

Profit

The firm's main goal or objective is the maximize profit. As we all know, profit is computed as the difference of Total Revenue and Total Cost.

Total Profit = TR - TC

Total Revenue

Total revenue profit is a combination of two accounting principles. Total revenue is the income a business receives from the sale of all the goods produced. Total profit is determined by subtracting total costs from revenues. Total revenue is determined by multiplying the price received for each unit sold by the number of units sold. Total revenue profits are a product of subtracting total costs from total revenue.

TR = P X Q

Total Costs

Economists include two types of costs in the total cost calculations. **Explicit costs** are items such as rents, productions costs and labor costs. **Implicit cost** or opportunity costs express the cost of giving up something tangible for the prospect of return at a later date. **Total costs** are the sum of explicit costs and implicit costs. Total costs provides broader cost accounting than a bookkeeper would document on a journal or financial report.

Often for small businesses, they are resources contributed by the owners; for example, working in the business while not getting a formal salary, or using the ground floor of a home as a retail store. Implicit costs also include the depreciation of goods, materials, and equipment that are necessary for a company to operate.

The Idea of Opportunity Cost

Since resources are limited, every time you make a choice about how to use them, you are also choosing to forego other options. Economists use the term **opportunity cost** to indicate what must be given up to obtain something that's desired. A fundamental principle of economics is that every choice has an opportunity cost. If you sleep through your economics class (not recommended, by the way), the opportunity cost is the learning you miss. If you spend your income on video games, you cannot spend it on movies. If you choose to marry one person, you give up the opportunity to marry anyone else. In short, opportunity cost is all around us.

The idea behind opportunity cost is that the cost of one item is the lost opportunity to do or consume something else; in short, opportunity cost is the value of the next best alternative.

Since people must choose, they inevitably face trade-offs in which they have to give up things they desire to get other things they desire more.

ECONOMIC PROFIT VERSUS ACCOUNTING PROFIT

Economic Profit

Economic profit is more or less similar to accounting profit because it deducts the explicit costs from the earned revenue but it also includes implicit and opportunity costs.

Accounting profit can be termed as the actual gains & losses earned by the business in a particular year. It defines the health of the business whether it is profitable or not. It is also known as a net income of the organization after subtracting all possible explicit costs.

PRODUCTION AND COSTS

The production function shows the relationship between quantity of inputs used to make a good and the quantity of output of that good. Figure 5.2 shows the graph of production function, the marginal product and average product.

Along the production function curve, you can notice the marginal product. The marginal product of any input in the production process is the increase in output that arises from an additional unit of that input. It is the slope of the production function curve.

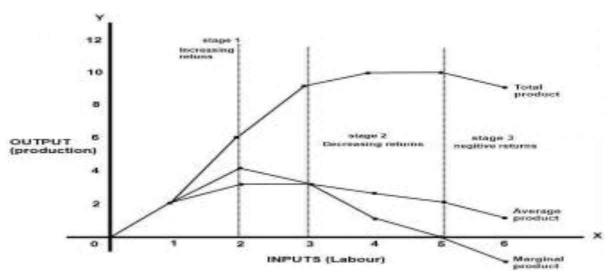


Figure 5.2

Production Function, Marginal Product and Average Curve

Relationship between Production Function, Marginal Product and Average Product

As shown in Figure 5.2, total product (TP) function is increasing while marginal product (MP) and average product (AP) are in decreasing pattern. But when the firm added the 6th worker, total product starts to decline.

As you can notice at 6th worker, the marginal product (MP) curve starts to intersects x axis which means marginal product is equal to zero. Another thing that is noticeable from the graph is that when the MP intersects the AP, AP starts to decline.

In short, the relationship of the production curves is as follows:

1. When TP is on its peak, MP is equal to zero.
2. When TP starts to decline, MP is negative.
3 . When MP is equal to AP, AP starts to decline.

Law of Diminishing Marginal Productivity

As we can noticed from the graph, MP is declines as we add more and more units of labor. This can be explained by the **law of diminishing marginal productivity or marginal return**. The law states that as the firm adds extra units of inputs, the marginal product declines, holding other variables constant.

An example of this situation is, imagine you are working in a plant site with the size good enough with 3 machines and workers. At first, when you are the only one worker, definitely you are very productive since you can utilize the three machines and the whole plant size. But as you add more and more workers, time will come that you need to pause for a while and wait the machine to vacate so you can operate. Therefore, there will be idle time which leads to decline of marginal product.

THE VARIOUS MEASURES OF COST

Variable Costs and Fixed Costs

All the costs faced by companies can be broken into two main categories: **fixed costs** and **variable costs**.

Fixed costs are costs that are independent of output. These remain constant throughout the relevant range and are usually considered sunk for the relevant range (not relevant to output decisions). Fixed costs often include rent, buildings, machinery, etc.

Examples of fixed costs include:

- Building Rent
- Insurance Payments
- Subscription Fees
- Utilities Payments

The most significant benefit of fixed costs is they are easy to budget. You know over each period what these costs will be, and you don't need to make any budget accommodations if production increases suddenly.

Variable costs are costs that vary with output. Generally variable costs increase at a constant rate relative to labor and capital. Variable costs may include wages, utilities, materials used in production, etc.

Some examples of variable costs are:

- Sales Commissions
- Shipping Costs
- Hourly Labor Costs

- Raw Materials

Variable costs are less predictable to a business owner, though they do typically go up or down in relation to production. If your company makes furniture and receives a big order, it will see an increase in expenses like wood, sandpaper, and other materials that are needed to craft a piece of furniture. How much of those materials you buy is dependent on the demand for your products. This is why it's essential to forecast your business expenses ahead of time and make sure you leave room in your budget to accommodate for an increase in variable costs.

Q	TFC	TVC	TC	MC	AFC	AVC	ATC
0	50	0	50				
1	50	50	100	50	50	50	100
2	50	78	128	28	25	39	64
3	50	98	148	20	16.67	32.67	49.33
4	50	112	162	14	12.50	28	40.50
5	50	130	180	18	10	26	36
6	50	150	200	20	8.33	25	33.33
7	50	175	225	25	7.14	25	32.14
8	50	204	254	29	6.25	25.50	31.75

The sum of your fixed cost and variable cost is the total cost.

Most of the time, economist deals with the average total cost. **Average total cost** is the quotient of total cost and total output.

$$ATC = TC / Q$$

Average total cost is important to determine because it depicts the cost incurred of 1 unit of product. Hence, it can be used as the basis for your pricing. Remember that your price must be greater than ATC.

Average fixed cost is the quotient of fixed cost and the quantity. This depicts the fixed cost incurred of ever unit of product.

$$AFC = TFC / Q$$

Average variable cost is the quotient of variable cost and quantity. It denotes the variable cost incurred of 1 unit of product.

$$AVC = TVC / Q$$

Marginal cost (MC) measures the increase in total cost that arises from an extra unit of production. Marginal cost helps answer the following question:

How much does it cost to produce an additional unit of output?

$$MC = \frac{CHANGE\ IN\ TOTAL\ COST}{CHANGE\ IN\ QUANTITY} = \frac{\Delta TC}{\Delta Q}$$

Applying the formula, we may fill up the table:

HYPOTHETICAL COSTS SCHEDULE

Short run

- In the short run one factor of production is fixed, e.g. capital. This means that if a firm wants to increase output, it could employ more workers, but not increase capital in the short run (it takes time to expand.)
- Therefore in the short run, we can get diminishing marginal returns, and marginal costs may start to increase quickly.
- Also, in the short run, we can see prices and wages out of equilibrium, e.g. a sudden rise in demand, may lead to higher prices, but firms don't have the capacity to respond and increase supply.

Long run

- The long run is a situation where all main factors of production are variable. The firm has time to build a bigger factory and respond to changes in demand. In the long run:
    - We have time to build a bigger factory.
    - Firms can enter or leave a market.
    - Prices have time to adjust. For example, we may get a temporary surge in prices, but in the long-run, supply will increase to meet it.
    - The long run may be a period greater than six months/year
    - Price elasticity of demand can vary – e.g. over time, people may become more sensitive to price changes, in short run, people keep buying a good they are used to.

CHAPTER 5 EXERCISES

Name: ____ **Score: _________________**

Year/Course/Section: ____________________________ **Schedule: ______________**

I . **Identify** the word or phrase being described by the statements. Write the your answer on the space provided.

________________________ 1. It is the motivation of the firm.
________________________ 2. It is the total amount of product being sold.
________________________ 3. Cost incurred with direct monetary lay-out.
________________________ 4. Cost that varies with your production,
________________________ 5. Extra or added unit of output produce in every one unit of inputs added in the production.

II . Identify the following Costs: Write **VC** if its Variable Cost or **FC** if it is Fixed Cost.

_____________ 1. Labor
_____________ 2. Taxes
_____________ 3. Electricity
_____________ 4. Building
_____________ 5. Equipment
_____________ 6. Office supplies
_____________ 7. Telephone bills
_____________ 8. Water
_____________ 9. Land
____________10. Machinery

MODULE 6 - READING

CHAPTER VI

MARKET STRUCTURE

OBJECTIVES:

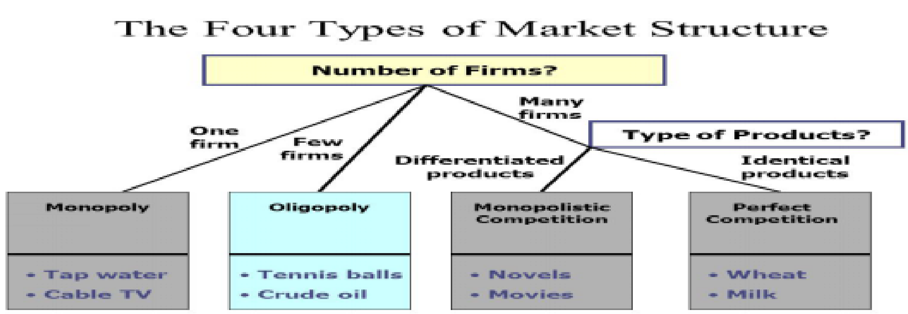
- ➢ To know the concept of market
- ➢ To describe the different structure and its role in giving fair market price.
- ➢ Give examples of products existing under different market structure; and
- ➢ To understand and hoe to compute for profit and total revenue under each market structure.

Market – This refers to the place where the consumers and the producers buy and sell products at an agreed price.

Market Structure – This refers to the degree of competition in the market for a particular product or services.

The same with the firm, its behaviour varies depending on its environment which is known as the market structure. Market Structure is divided into four types, the perfect competitive market, monopoly, oligopoly, and monopolistic competition.

In this book, we're going to learn the characteristics of different market structure.



Perfect Competitive Market

A Perfect Competitive Market is a market structures composed of many buyers and many sellers selling the same product. A *perfectly competitive* market has the following characteristics:

- ➢ **There are many buyers and sellers in the market.** An industry that consists of many small buyers and sellers is one of the characteristics of a perfectly competitive industry.

➢ **The products sold by the sellers are homogenous**. The sellers sells products that consumers perceive as being identical products.

➢ **Firms can freely enter or exit the market**. Equal access to resources refers to a condition in which all firms – those currently in the industry, as well as prospective entrants – have access to the same technology and inputs.

➢ **Perfect information about prices**. It means that consumers are fully aware of the prices charged by all sellers in the market. Future price should also be considered in order to attain a thorough knowledge in ricing the commodity.

Example: a. Basic needs like food: rice, sugar, eggs, and chicken, meat, and fish; Clothing: unbranded t-shirts, pants, socks, etc.

b. There is no need to advertise or promote because these are all basic needs.

Note: Basic food especially the agricultural products sold on the market are being regulated by the Philippine government by having price ceiling and price floor to secure the welfare of the people.

Imperfect Competition refers to any economic market that does not meet the rigorous standards of a hypothetical perfectly or purely competitive market. In this environment, companies sell different products and services, set their own individual prices, fight for market share and are often protected by barriers to entry and exit.

Assumptions:

➢ As to type of products, they are not the same. Differentiated in features though gives the same satisfaction.

Example: bath soap, toothpaste

MONOPOLY – A sole producer and has no close substitute. Since there are no rivals it can push through on whatever price the producer wants the public to take. He can even fix price and determine his own price policy and leave the consumer's decision as to how many would they take given the price of the product.

➢ **It is the sole seller of its product or the only producer of goods and services.** This gives a reason why the seller in this type of market is price maker while the consumers are price taker. Firms are the one which can set the price since it is the sole seller.

- **Its product does not have close substitutes**. There are times that you are the sole seller of the said products but the problem is that there are goods or services which can satisfy the same needs and wants. If this case occur in the market, you cannot be consider as monopoly since seller does not have the control in the market. Consumer can make a choice between two products.

Monopoly arises because of the barriers to entry. These barriers usually fall in this category

1. **Economic in Nature** – In some industries, consumers are best served by a single firm and are not profitable for some other firms to enter the field of a monopolist. Imagine the technology used in the production of energy. The technical know-how and the capital outlay in producing electricity is so heavy. Small producer could not enjoy economies of scale.

Institutional or Artificial Barriers:

a. Exclusive Ownership
b. Patent Rights and Copy Rights
c. Market Franchise
d. Cut throat competition – price cutting

1. Simple monopolies – charges the same price to all customers for the same

Commodity. *Example*: Kilowatt used

2. **Discriminating Monopolies –** charges different prices to different customers for the same commodity. *Example*: Airtime for domestic and overseas.

OLIGOPOLY

This is the market structure that lies between perfect competition and monopoly. Oligopoly is a market structure having **few sellers**.

The characteristics of an **Oligopoly** market are as follows:

- Few sellers offering similar or identical products. There is no specific number as long as there are few sellers in the market.
- Interdependent firms. The firm under this type of market depend on each other. The action of one firm has noticeable effect on the other firm.
- Best off cooperating and acting like a monopolist by producing a small quantity of output and charging a price above marginal cost.

Because of the few sellers, the key feature of oligopoly is the tension between cooperation and self-interest.

Cooperation is a situation in which firms under the market creates either collusion of cartel.

3. ***Collusion*** is an agreement among firms in a market about quantities to produce of prices to charge,
4. ***Cartel*** is a group of firms acting monopolistically. An example of Cartel is OPEC. (Organization of Petroleum Exporting Countries).

Self interest is condition in which the competition prevails among the group of sellers in the industry. This is the opposite of cooperation. Because of self interest, strategic planning exists. Firms must know to play the game of gaining customers.

It seems that cooperation is favourable on the part of the firm. But, on the part of consumer, it is not. Competition among sellers id goods for the consumers because it tends to lower the price of commodity. This is the reason why cartel and collusion is prohibited by law.

Product and services under this market structure include the oil and telecommunication. These industries are composed only of few firms competing in the market.

MONOPOLISTIC COMPETITION

Monopolistic competition is a type of market structure in which a relatively large number of small producers or suppliers are offering or selling similar but not identical products. These firms are less than in number compares to perfect competition but more than the number compared to perfect competition but more than the number of firms in oligopoly. The firms under this market structure sell differentiated product. The cost incurred in producing the goods varies on the raw materials they used in production.

The characteristics of Monopolistic Competition are the following:

1. **Many sellers** . This characteristics of this type of market is being adopted in the perfect competitive market. From under perfect competition have millions of buyers and sellers of a product compared to monopolistic competition.
2. **Product differentiation**. In this type of market, the product is differentiated of heterogeneous. Each product produced by a certain firm is not similar to those produced by other businesses. Firms race relatively close substitutes and most commodities are not completely homogeneous. Monopolistically competitive producers produced variations of a given product. For example is shampoo, the product of each firm producing shampoo differs from its rival in various ways. There are different brands of shampoo where they can choose from.
3. **Free entry and exit**. Unlike the monopoly and oligopoly, there are low barriers to entry in this type of market. The technology adopted by this firm most of the time is not too sophisticated which requires small amount for capitalization. Legally, government does not give sole right to produce the commodity. The government requirements needed are the business permit, sanitary permit and others. Besides from that, there are no legal barriers in this type of market structure.

Examples of products under this type of market structure are toothpaste, shampoo, bath soaps, novel, books, restaurants, apparels among others. If you observe the way of setting their price, each firm can set its own price. Even the product itself is different in specification but similar in nature.

SUMMARY OF THE CHARACTERISTICS OF MARKET STRUCTURES

PRODUCT MARKET MODELS				
CHARACTERISTIC	**Pure Competition**	**Monopolistic Competition**	**Oligopoly**	**Monopoly**
Number of firms	Very many	Many	Few	One
Type of product	Standardized (Homogenous)	Differentiated	Standardized or differentiated	Unique, no close substitutes
Control over price	None (price takers)	Some, depends on product differentiation	A lot with collusion, limited with mutual interdependence	A lot
Barriers to entry	Very easy, no barriers	Relatively easy	Significant barriers	Blocked
Nonprice competition	None	Very much	Very much with differentiated products	Would expect none, but some public relations advertising
Examples	Agriculture (like wheat, soybean, corn); stock market	Restaurants, hotels, pubs, retail trade (pharmacies, gas stations, grocery stores)	Steel, automobiles, farm implements, smart phones, video streaming, airlines, health insurance	Local public utilities (electricity, natural gas, water)

CHAPTER 6 EXERCISES

Name: ____ **Score: __________________**

Year/Course/Section: ______________________________ **Schedule: ______________**

I . Determine what market structure being described by the following characteristics. Write letter that corresponds to your answer on the space provided. You may have two answers in one number.

- **A. PERFECT COMPETITIVE MARKET**
- **B. MONOPOLY**
- **C. OLIGIPOLY**
- **D. MONOPOLISTIC COMPETITION**

___________ 1. Can set their own price.
___________ 2. Many buyers, only one seller.
___________ 3. Many buyers, many sellers, homogeneous product.
___________ 4. Many buyers, many sellers, heterogeneous product.
___________ 5. Must act strategically.
___________ 6. Firms are price taker.
___________ 7. Has very low barrier to entry.
___________ 8. Can easily exit in the industry.
___________ 9. Market with only few sellers.
___________ 10. The product produced has no close substitute.
___________ 11. Do not need advertisement.
___________ 12. May or may not engage in advertisement.
___________ 13. Has no control over price.
___________ 14. Cut throat competition
___________ 15. Has a cartel.

II . Identify what market structure do the following product fall. The market is in terms of national market.

_____________________________________ 1. T-shirt
_____________________________________ 2. Car
_____________________________________ 3. Telecommunication
_____________________________________ 4. LRT
_____________________________________ 5. Rice
_____________________________________ 6. Vinegar
_____________________________________ 7. Furniture
_____________________________________ 8. School supplies
_____________________________________ 9. Roses
_____________________________________10. Appliances

MODULE 7 - READING

CHAPTER VII

INFLATION

Learning Objectives

- define inflation
- distinguish between two types of inflation
- define and explain the causes of cost-push and demand-pull inflation.
- explain why the consumer price index (CPI) overestimates actual inflation.
- explain the effect of inflation on borrowers and lenders.

Inflation is a situation of rising prices in the economy. It is an increase in the cost of living as the price of goods and services rise. The rate of inflation measures the annual percentage change in the general price level.

INFLATION LOSERS:

- **Fixed Income Earners are affected during inflation**. With increased in prices, people who belong to this group would lose out because the income they receive now would be able to buy less than before.
- **Pensioners from SSS or GSIS** are also inflation losers since the amount of the monthly pension that they receive is fixed and is not adjusted with inflation hike. Would result in a net loss to the pensioner.
- **Creditors** lose out during inflation because the fixed amount of principal and interest they lent out would now have lesser value once the money will be returned to them.

INFLATION GAINERS:

- **Flexible income earners**. Business would gain more if prices of commodities they produce and sell go up. An increase in inflation means that their income would obviously register a bigger gain since they can sell their products at a higher price.
- **Speculators** are inflation gainers when they perceive that the inflation rate will increase. They will buy goods at cheaper prices and then sell them later at higher prices, because of increase in inflation rate.
- **Debtors** are gainers because the value of the money they borrowed before would now have more value considering the present value of money before an inflation hike.
- **Borrowers from SSS and GSIS through housing loan.** They are gainers since they have built houses before where prices of all construction materials were still affordable.

THEORIES OF INFLATION:

1. ***Demand-Pull Inflation*** exists when aggregate demand for a good or service outstrips aggregate supply. It starts with an increase in consumer demand. Sellers meet such an increase with more supply. But when additional supply is unavailable, sellers raise their prices. It occurs under the following situations:

- **Increases in the money supply -** If an economy has too much money among its citizens, they will demand more product than firms can keep up with, pulling up prices.
- **Increases in government spending -** When the government spends large amounts of money in the private sector through purchases and contracts, this increases demand for products and creates supply issues, ultimately pulling up prices.
- **Foreign growth or foreign price increases -** If prices are rising in other countries, foreign consumers may demand the domestic products you buy at cheaper rates. This increase in demand can result in higher prices paid by you. If other countries experience large population growth, this can result in foreign citizens demanding more products from other countries and pulling up prices, too.
- **Another reason is during elections** – Election campaigns include a big amount of expenditures injected into the economy.

2. **Cost-Push Inflation** occurs when overall prices increase (inflation) due to increases in the cost of wages and raw materials. Higher costs of production can decrease the aggregate supply (the amount of total production) in the economy. Since the demand for goods hasn't changed, the price increases from production are passed onto consumers creating cost-push inflation.

- Increase in the price of oil results to a major increase in the general price level of all the commodities.
- Increased salary and wages of the workers will increase in the salary and wages of the workers will increase in the price of goods and services since the employer have no recourse but pass on the higher prices to the consumers.
- Monopolies in the society. If more monopolies are encourage, they have the tendency to increase their mark-up as much as would be profitable.
- Devaluation of the Philippine peso. When this happens, it would be more expensive to import goods. Since our economy is a highly import-dependent economy, higher cost of import means higher prices. If the prices of crude oil and capital goods increases, the increase in costs would be passed on to the consumers.

MEASUREMENT OF PRICE INCREASES:

1. Consumer price index, measure of living costs based on changes in retail prices. Such indexes are generally based on a survey of a sample of the population in question to determine which goods and services compose the typical "market basket." These goods and services are then priced periodically, and their prices are combined in proportion to the relative importance of the goods. This set of prices is compared with the initial set of prices (collected in the base year) to determine the percentage increase or decrease. Consumer price indexes are widely used to measure changes in the cost of maintaining a given standard of living.

2. RETAIL PRICE INDEX

The retail price index measures the change of average prices over a certain amount of time. The measurements are made by recording the essential goods and services people are expected to buy, putting them into an imaginary shopping basket called the "Basket of Goods".

A price index is shown as a single number which indicates the price change in a number of different goods. This is calculated by comparing the price of goods to the base year.

3. Wholesale Price Index (WPI)

A wholesale price index (WPI) is an index that measures and tracks the changes in the price of goods in the stages before the retail level – that is, goods that are sold in bulk and traded between entities or businesses instead of consumers. Usually expressed as a ratio or percentage, the WPI shows the included goods' average price change and is often seen as one indicator of a country's level of inflation.

4. **Stock Market Index**

A stock market index is a measure of a stock market, or a smaller subset of the market, that helps investors compare current price levels with past prices to calculate market performance. Investors use the calculated values of stock market indexes as an indicator of the current value of their component stocks, and they can determine returns over time by comparing current and past index levels.

Stock market indexes come in many different sizes. Some indexes have only a handful of stocks that determine their value, while others take thousands of stocks into account. You can't invest directly in a stock market index, but by investing in index funds that allow investors to track the performance of those indexes, you can make money and profit when those indexes go up . These index funds can be structured as mutual funds or exchange-traded funds (ETFs).

INFLATION RATE

Inflation refers to a general rise in prices measured against a standard level of purchasing power. Previously the term was used to refer to an increase in the money supply, which is now referred to as expansionary monetary policy of monetary inflation. Inflation is measure by comparing two sets of goods at two points in time, and computing the increase in cost not reflected by an increase in quality. There are therefore, many measures of inflation depending on the specific circumstances. The most well-known are the CPI which measures consumer prices, and the GDP deflator, which measures inflation in the whole of the domestic economy. The prevailing view in mainstream economics is that inflation is caused nu the interaction of the supply of money with output and interest rates. Mainstream economist views can be broadly divided into two camps: the "monetarists" who believe that monetary effects dominate all others in setting the rate of inflation and the "Keynesians" who believe that the interaction of money, interest and output dominate over the effects. Other theories, such as those of the Australian school of economics, believe that an inflation of overall prices is a result from an increase in the supply of money by central banking authorities. Related concepts include: **deflation**, a general falling level of prices; **disinflation,** the reduction of the rate of inflation; **hyper-inflation**, an out-of-control inflationary spiral; **stagflation,** a combination of inflation and poor economic growth; and **reflation,** which is an attempt to raise prices to counterpart deflationary pressures.

CHAPTER 7 EXERCISES

Name: ____ **Score:** _________________

Year/Course/Section: ____________________________ **Schedule:** _____________

ASSIGNMENT AND ASSESSMENT

I. IDENTIFICATION:

________________________________ 1. The perceptive and lucky individuals who are able to buy goods at cheaper prices and then sell them later at higher prices.
_______________________________ 2. A condition of general price increases which reduces the amount of goods and services that money can buy.
________________________________ 3. Refers to the pressure of prices brought about by excess demand over supply.
________________________________ 4. A measure of price increase which provides a general measure of average monthly and annual changes in the retail prices of commodities ought by consumers.
________________________________ 5. This pushes prices up when the expenses incurred in production increases.
________________________________ 6. Inflation losers who lose out because the income they receive at present would be able to buy less than before.
________________________________ 7. Inflation gainers who gain more if prices of commodities they produce and sell go up.
________________________________ 8. Inflation losers wherein the fixed amount of principal and interest they lent out would have less value when inflation rate increases.
________________________________ 9. A measurement of price increase which is intended to provide a general measure of average monthly and annual changes in the retail prices of commodities commonly bought by consumers covering all income household.
________________________________ 10. A measurement of price increase which is designed to measure monthly changes of the price at which retailers dispose of their goods to consumers and end users.

II. Write **TRUE** if the statement is correct and **FALSE** if it is wrong.

_____________ 1. When peso depreciates, consumers can buy more goods and services.
_____________ 2. The greater the volume of transaction in the economy, the lower the level of money is required to finance the transactions.
____________ 3. When there is an increase in demand, prices will tend to go up and output of goods and services would tend to decrease.
____________ 4. Creditors lose out during inflation because the fixed amount of capital and interest they lent out would now be valued less.
____________ 5. When peso depreciates, the cost of imports will be higher.
____________ 6. Demand pull inflation occurs when monopolies are permitted in a society.
____________ 7. Pensioners gain during inflation because the amount they receive is directly proportional to the rate of inflation.
____________ 8. When demand of peso results exceeds supply, cost push inflation is experienced.
____________ 9. Devaluation of peso results to increase in purchasing power of money.
____________ 10. When peso appreciates, more goods and services can bought.

MODULE 8 - READING

CHAPTER VIII

LABOR AND EMPLOYMENT

Human resources is the set of the people who make up the workforce of an organization, business sector, industry, or economy. A narrower concept is human capital, the knowledge which the individuals embody. Similar terms include manpower, labour, personnel, associates or simply people.

A human-resources department (HR department) of an organization performs human resource management, overseeing various aspects of employment, such as compliance with labor law and employment standards, administration of employee benefits, organizing of employees files with the required documents for future reference, and some aspects of recruitment and employee off boarding.

LABOR PROBLEMS

Labor problem is a working situation conflict which is considered below the ideal. Contracts between the employees and the employer are governed by the policies of the Department of Labor and Employment (DOLE). Now, if the employees feel that the employment policies are not fully implemented by their employer, conflict or labor problems exists.

1.Unemployment

An individual suffers social dislocation and depression if he is not employed. A person is considered unemployed if he is 15 years of age, willing and able to work but cannot find jobs. Unemployment is both economic and social problem. Unemployment can lead to social dissatisfaction and petty crimes. Crimes like robbery, hold-ups, drug trafficking and others are usually caused by unemployment.

Forms of Unemployment

1.1 ***Unproductive Unemployment*** is a situation wherein people are not gainfully employed by choice. This means that they chose not to be employed. Examples are the housewives and college students.

1.2 ***Frictional Unemployment*** is a situation where some workers have special skills but these skills cannot be utilized in any type of work. So rather than work on jobs which do not utilize one's skills, they would rather choose to stay idle or out of work for a while. Examples are the nursing graduates working as salesclerk.

Disguise Unemployment is a situation when workers who are laid off when their contractual work is completed. While waiting for another contract that would need their special skills, workers accept minor jobs just to fill their time. Examples are the OFW who finished their contract abroad while waiting for the next contract, they would choose to accept other jobs.

2. Underemployment

This is a situation wherein people are employed but they work for less that forty (40) hours per week despite the fact that they want to work for more than 40 hours. Underemployment usually exists in part time workers like those who work part time in the food chains, jeepney drivers, among others.

Subdivisions of Underemployment

2.1 Visible Underemployment is a situation wherein people are working for less than 40 hours per week and wanting additional hours of work. This exists among part time workers.

Invisible underemployment exists when workers work for more than 40 hours or more per week and still wanting additional hours of work. This exists among street vendors.

2.2 Inadequate Wage. Wages which are insufficient and fail to provide the minimum requirements for his family to live a comfortable life is considered inadequate wage, inadequate wages result from the inability of wages to catch up with the increases in the prices of basic commodities. It can also result from the inability of the workers to provide himself with the needed skills and intelligent to perform work needed by most of the firms.

The **Department of Labor and Employment (DOLE)** defined poverty as the condition where a family receives insufficient income to purchase or meet the recommended minimum nutrient requirements and basic needs in food, clothing, education, medical care, housing and fuel.

The concept of subsistence income is the level of income which affords only minimum consumption of basic necessities.

This income is called the poverty threshold, below which family is considered poor.

3. Industrial and Labor Management Conflict

When the management of any company has been unfaithful and has not fully implemented what is due to the employees, then labor-management conflict will arise. When workers resorted to strike or when employers resorted to lockout, inconveniences will follow and will be harmful to both the employer and employees. Work stoppages could result in lower production, less sales, less income for the employees and employer.

3.1. ***Strike***, is a temporary work stoppage, caused by the mass refusal of employees to work. A strike usually takes place in response to employee grievances.

Most strikes are undertaken by labor unions during collective bargaining as a last resort. The object of collective bargaining is for the employer and the union to come to an agreement over wages, benefits, and working conditions. A collective bargaining agreement may include a clause (a contractual "no-strike clause") which prohibits the union from striking during the term of the agreement.

3.2 Lockout is a work stoppage or denial of employment initiated by the management of a company during a labor dispute. In contrast to a strike, in which employees refuse to work, a lockout is initiated by employers or industry owners. Lockouts are usually implemented by simply refusing to admit employees onto company premises, and may include changing locks or hiring security guards for the premises. Other implementations include a fine for showing up, or a simple refusal of clocking in on the time clock.

Generally, lockout is an attempt to enforce specific terms of employment upon a group of employees during a dispute. It is often used to force unionized workers to accept new conditions, such as lower wages. If the union is asking for higher wages, better benefits, or maintaining benefits, a manager may use the threat of a lockout – or an actual lockout – to convince the union to back down.

3.3 Economic Insecurities. People need to provide funds for emergencies like illness, accidents, and threats of strikes or lockouts. If workers cannot provide funds for all of these because their wages are just enough to meet subsistence, therefore, provisions for emergencies could not be met.

Threats of interruptions of inconsistencies in earnings is considered to be a serious economic problem. A head of the family would feel very insecure if he is not sure that his job would not be stable or would last long. Forms of economic insecurities include illness, accidents, threats of strikes or lockouts, retirements, end of contracts, among others.

OBJECTIVES AND POLICIES OF LABOR AND EMPLOYMENT

1. Generation of More Employment and Livelihood Opportunities

A country’s recovery depends on the refocusing of economic priorities which is an essential component of the country’s recovery. Generation of more employment will provide additional livelihood opportunities that will lead to better income. The policy is directed to promote cottage, small and medium scale industries as well as labor intensive enterprises using indigenous raw materials. The government is expected to provide financial support in the form of seed capital, priming activities, technical support, marketing and promotions as well as expansion and growth. These will be the instruments to foster the values of self-reliance, self-help and self-determination among the beneficiaries.

The focus of the investment program will shift from large scale and foreign exchange oriented activities to the small and medium scale and less foreign exchange dependent. Investment activities will promote employment with emphasis on agro-based industries like the development of off-farm employment opportunities in support of balanced agro-industrial development. The provision of initial financial support to smaller-scale industries and self-employment programs will be a major component of credit and monetary policies. The labor intensive methods will be used in the construction of infrastructure projects.

2. Promotions of Employment

The promotions of local and overseas employment includes intensive training, rational and efficient allocation of manpower resources and improvement of better employee services.

Local Employment

Local employment services will be strengthened through the continued operation of an efficient labor market information system to accurately monitor the employment situation. Structural changes aimed at enhancing the effectiveness of public employment exchange centers and at improving data retrieval and collection between the government and the private sector.

Employment guidance services will developed through the establishment of linkages with concerned private groups and associations. The employment services include testing, counselling, referrals both to training and jobs and placement through various programs and project will continuously by undertaken. The placement and recruitment activities of local placement agencies will be regulated by streaming existing policies and systems and procedures related to these activities.

The apprenticeship and learnership system will be improved through proper implementation, closer monitoring and continuous review. Vital linkages with relevant sectors will also be strengthened through the establishment of training schemes that have built-in mechanisms for the ready absorption of graduates.

A. Overseas Employment

The policy on overseas employment is to promote the responsiveness of local labor supply to overseas demand along with the continuous development of the domestic market's ability to absorb labor.

In view of the projected contraction in the market for expatriate labor particularly in the Middle East and in anticipation of new labor entrants, a more aggressive marketing program will be devised. Market diversification will include non-traditional areas like Europe, Latin America, Asia and the Pacific and Africa. Labor skills will also be diversified to meet the manpower requirements of these new markets. Overseas employment standards will be improved to realign them to international labor standards.

A more strategic placement scheme will be pursued to better serve the needs if the international market without necessarily jeopardizing the quality of manpower made available for domestic employment. The overseas employment market will be tapped through a system of responsible and selective recruitment of labor and through the encouragement of subcontracting of projects abroad. Licensing and regulation will be stepped up to prevent exploitation practices particularly illegal recruitment. A modified system for accrediting foreign principals and projects will continue to be implemented.

A comprehensive package of measures will be provided to overseas workers at all stages: before departure, while working abroad and upon return to the country. Pre-employment assistance to overseas-bound workers will continue to be provided to enable workers to cope with adjustment difficulties in their countries of employment. Protection of workers at worksites will be ensured. The rehiring of workers for overseas jobs will be undertaken through the Balik-Manggagawa Assistance Program. The re-entry of returning workers into the domestic labor market will be facilitated through the tapping of private sector resources.

Welfare assistance measures and ad justification services will continue to be extended to overseas workers and their families. These will cover the immediate settlement of complaints.

B. Protection of Workers

Appropriate policies and programs will be adopted to ensure every working man to just, reasonable and humane terms and conditions of work. Specific groups of workers such as women, minors, rural workers and those in the informal sector will continue to accorded protection in accordance with the provisions of the Labor Code.

Women's participation in the labor market will be increased through the provision of greater opportunities for employment and the development of concomitant support system like day care centers. Special protection will be given to minors and youth workers. The welfare of rural workers will be enhanced through the expansion of existing welfare schemes to cover all types of workers.

The policies relative to the employment of aliens will be reviewed to take into consideration various factors such as job protection of local workers, foreign investment opportunities and transfer of technology. The entry of alien workers in those areas where local manpower or expertise is not available will continue to be regulated. In particular, the Alien Employment Permit System and the Understudy Training Program will be strengthen.

C. Maintenance of Industrial Peace

As a measure to ensure industrial viability and stability of employment, a labor relations policy conducive to a healthy labor-management relationship will be enforced vigorously.

The use of the present modes of dispute settlement shall be maximized while new or indigenous approaches will be developed to assure the expeditious and judicious settlement of disputes. The grievance machinery and voluntary arbitration will be strengthened with preventive mediation and conciliation as complementary modes of disputes settlement.

At the same time, labor education and labor-management cooperation schemes will be promoted to minimize adversative relations and enhance labor management partnership in development efforts. Workers organization and unionism will continue to be encouraged. New and innovative approaches to collective bargaining consistent with out cultural and value system will be developed.

D. Enhancement of Labor Productivity

Within the framework of the national productivity improvement program, efforts to enhance worker's productivity will be stepped up. Measures to increase worker's as well as employer's consciousness of the need for productivity improvement will sustained. Approaches and techniques in the areas of training, research and other supportive activities for the improvement of national productivity, including labor productivity will be continuously developed, promoted and disseminated.

E. Development of Appropriate Technology

The policy in this area will be directed to the reconciliation of the aims of technology development with employment objectives. Accent will be made on the development of those types of technologies that ensure the effective mobilization of labor and the promotion of labor productivity. A re-orientation of the existing research and development program to one which emphasizes labor productivity facilities rural to be undertaken. The adoption of technologies appropriate to local conditions will also be promoted. Through nationwide manpower training, appropriate skills to implement these technologies will be developed.

Endeavors in this area such as Kabataang Barangay National Manpower and Youth council (KB-NMYC) appropriate Technology Program will be encouraged. This program seeks to stimulate and actively involved the youth in the development and implementation of simple technologies at the countryside.

CHAPTER 8 EXERCISES

Name: ____ Score: _________________

Year/Course/Section: ____________________________ Schedule: _____________

I. IDENTIFICATION:

____________________ 1. The perceptive and lucky individuals who are able to buy goods at cheaper prices and then sell them later at higher prices.
____________________ 2. A condition of general price increases which reduces the amount of goods and services that money can buy.
____________________ 3. The temporary refusal of an employer to furnish work as result of labor dispute.
____________________ 4. This result from the inability of wages to catch up with the increase in prices.
____________________ 5. With social ideals that normally rise out of employment.
____________________ 6. A condition where a family receives insufficient income to meet recommended nutrient requirements and his basic needs.
____________________ 7. A condition wherein people who are willing and able to work cannot find jobs.
____________________ 8. Form of unemployment where persons choose to stay idle or out of work for a while if their skills cannot be utilized in any type of work.
____________________ 9. An association of employees which exist in whole or in part for the purpose of collective bargaining.
____________________ 10. An area of labor problem wherein workers are working for less that forty (40) hours a week and wanting additional hours of work.

II. Write TRUE if the statement is correct and FALSE if it is wrong. I wrong, underline the word/s that makes it wrong.

______________ 1. Work stoppage brought about by labor dispute in less production, less sales and less income for labor and management.
______________ 2. If workers are insecure in their jobs of if their wages are just enough to meet subsistence, provision for emergencies could be met.
______________ 3. The number of people working less than 40 hours per week and wanting additional work is invisible underemployment.
______________ 4. Unemployment is a situation wherein people who are willing and able to work are able to find jobs.
______________ 5. Poverty is a condition where a family receives sufficient income to purchase or meet the recommend minimum nutrient requirements and basic needs.
______________ 6. Inadequate wage results from the inability of wages to catch up with the increase in prices.
______________ 7. Civilian labor force is the total employed and unemployed persons.
______________ 8. Strike is the temporary stoppage of work initiated by the employees.

______________ 9. Retirement is a form of economic insecurities.
______________ 10. Lockout is the temporary refusal of an employer to furnish work.

MODULE 9 - READING

CHAPTER IX

NATIONAL INCOME ACCOUNTING

LEARNING OBJECTIVES:

- why an economy's total income equals its total expenditure.
- how gross domestic product (GDP) is defined and calculated.
- the breakdown of income approach
- Show the equation framework of expenditure approach
- whether GDP is a good measure of economic well-being.

NATIONAL INCOME ACCOUNTING

National Income Accounting, a set of principles and methods used to measure the income and production of a country. There are basically two ways of measuring national economic activity: as the money value of the total production of goods and services during a given period (usually a year) or as the total of incomes derived from economic activity after allowance has been made for capital consumption.

The most commonly used indicator of national output is the **gross national product (GNP),** which is a measure of the total market value of currently produced finished goods and the value of services rendered. Because national output includes goods and services that are highly diverse in nature and some that are not in fact placed on the market, the determination of market value is difficult and somewhat imprecise. Nonetheless the use of a common basis of valuation makes it possible to obtain a total that fairly represents the level of output of a country. The rule that only currently produced goods and services should be counted ensures that only production occurring in the course of a given year is included and that any transaction in which money changes hands but no good or service does so in return (so-called transfer payments, *e.g.*, unemployment or social-security payments, gifts) is excluded. The rule that only finished or final goods must be counted is necessary to avoid double or triple counting of raw materials, intermediate products, and final products. For example, the value of automobiles already includes the value of the steel, glass, rubber, and other components that have been used to make them.

GROSS NATIONAL PRODUCT (GNP)

Gross National Product (GNP), total market value of the final goods and services produced by a nation's economy during a specific period of time (usually a year), computed before allowance is made for the depreciation or consumption of capital used in the process of production. It is distinguished from net national product, which is computed after such an allowance is made.

The GNP is nearly identical to **gross domestic product (GDP)** except that the latter does not include the income accruing to a nation's residents from investments abroad (minus the income earned in the domestic economy accruing to non-nationals from abroad). Gross national product is a convenient indicator of the level of a nation's economic activity. The definition has three limitations:

First, GNP does not include products which are not produced by the resources of the economy like imports. Since imports are not produced in the country, it is excluded in the GNP.

Second, GNP includes those products that can no longer be sued for higher level of production and therefore, have reached the highest level of production using the economy's resources. The products which are considered final are those which can be used for consumption and therefore, part of GNP. However, those products which are in their intermediate stage and are not yet ready for final consumption are not part of GNP. Different kinds of woods used to manufacture furniture are not part of GNP since they are still intermediate goods. Another example is the sugar exported to Japan for use in the manufacture of softdrinks is considered final in the Philippines. However, locally produced sugar canes are not final and therefore excluded from the process of transforming products to higher stages using the economy's resources. There sugar canes are not considered final goods and are not part of GNP.

The **third** limitation is the time, which eliminates those products not produced by the economy within the period of time accounted. Thus, shoes manufactured last 2017 but still unsold and stocked in 2018 are only final in 2017 but not in 2018. The definition classifies goods produced but unused in the period accounted as final regardless of the stage of production reached. These production stages are the highest level of transformation attained for the products in the period using the economy's resources. Consumption goods and production materials produced but unsold during the year accounted clearly fall under the category of unused final products in the form of stocks or inventories.

GNP ACCOUNTING: EXPENDITURE APPROACH

This approach identifies the final products and classifies them according to end use such as consumption, government, investment, and rest of the world known as exports.

The following equation show the framework of Expenditure approach:

$$\mathbf{GNP = C + I + G + (X\text{-}M) = - NFY}$$

Where: C = Consumption Goods and Services
I = Investment Goods
G = Government Spending
X = Exports
M = Imports
(X – M) = Net Exports
NFY = Net Factor Income from Abroad

Consumption Goods and Services (C)

These goods and services directly satisfy human wants and are used up or consumed during the income period. These make up the largest part of a nation's current flow of output. Examples are consumer durables, consumer non-durables and consumer services. Consumer durables include appliances, household furnishings and others. Consumers non-durables include food, medicines etc. While consumer services include education, medical, travel, and others.

Investment Goods (I)

This consists of capital goods and inventories which are used to produce more goods and services. Gross investment refers to all the capital goods used in the production of goods and services. Once these goods are used up and worn out, they have to be replaced. This is the replacement investment.

Examples of investment goods are new construction and durable equipment, new housing and public construction and increase in stocks of goods or inventories.

Government Spending (G)

This refers to all the government expenditures used to maintain the operations of the bureaucracy. This maybe in the form of public goods and public services. Public goods include good roads and bridges, public schools, public market, airports, harbors, among others. Public service include national defense, police and fire protection, too ways and others.

Exports (X)

These are the goods that are being sold to other countries.

Imports (M)

These are the goods that we buy from other countries

Net Exports (X – M)

Net export is minus import. The ratio between a country's imports to export is **Balance of Trade**. When a country has more exports than imports, there is a favourable balance of trade. However, when there are more imports than exports, unfavourable balance of trade is experienced.

Net Factor Income from Abroad (NFY)

This is the difference between the aggregate flow of factor payment from (+) and to (-) the rest of the world. A positive net factor income from abroad can attributed to inflows. Positive Net Factors income from abroad is brought about the increase in exports as it consists of payment for the use of the economy's resources, salary remittances of Filipinos working abroad and profit remittances of Filipinos investing abroad.

On the other hand, the negative new factor income from abroad can be attributed to outflows. Negative net factor from abroad is experienced when there are more imports than exports as it consists of payments for the economy's use of foreign resources like profit remittances of foreign multinational companies to their mother countries for their investment in the Philippines. Also the salary remittances of foreigners working here in the Philippines can contribute to negative net factor income.

Therefore, excluding the Net Foreign Factor Income from GNP leaves the value of Gross Domestic Product which is the value of final products produced by the resources in the economy.

Statistical discrepancy is an account assigned to the Expenditure approach. Statistical discrepancy is a theoretical account used to event out the practical differences between the GNP figures arrived in the computation of GNP using the 2 approaches. This account may register a positive or negative sign to adjust the overstated or understated GNP estimate.

GNP Accounting: Income Approach

GNP Income Approach = PY + CY + GY = NY

Add: IT – S

DA

Where: PY = Income of Persons
CY = Corporate Income
GY = Government Income
NY = National Income
IT = Indirect Tax
S = Subsidies
DA = Depreciation Allowance

Income of Persons (PY)

GNP is equal to the additive values of factor contribution in the process of transforming products into their final forms assuming all factor contributions as paid for to the resource owners. The direct payment of the producing units to the resource owners represent the resource owners' direct contributions to production known as factor contributions. It should be noted that resource owners (household) are distinct from the producing units but provide the producing units with the basic factors of production.

The additive values of the products in the whole production process results from the direct contribution of resource owners in every production stage to transform products of inputs to higher forms. This approach also has a built in mechanism to exclude imports and previously produced inventories but include currently produced inventories. The values of previously produced inventories are automatically excluded since their factor contributions are not reflected in the period accounted. It should be noted that factor contributions result from the use of land, labor, capital and entrepreneurship with rent, wages and salaries, interest and profit as their respective payments.

Corporate Income (CY)

This is the income earned by the corporations which is considered to be undistributed. This is part of the income earned but undistributed to its stockholders which means that when corporations earn, part of the income or their dividends will not be distributed to its stockholders but instead they will use this income for their expansion program or to boosts their operational capabilities.

Government Income from Capital (GY)

This is the income earned by the government when they assume the business role and becomes a factor contributor in essential areas where private enterprise creates a vacuum. Government enterprises are also concerned pat of the production system and produces private goods and services.

Indirect Taxes (IT)

These are the taxes indirectly paid to the government and are usually shouldered by the consumers. Examples are sales tax, value added tax, amusement tax and others.

Subsidies (S)

These are the financial help granted by the government to private and public enterprises. These are subtracted from indirect taxes. Subsidies are excluded since they only bloat profits and product values and do not entail production and factor contributions.

Capital Consumption Allowance of Depreciation allowance (DA)

This represents payments to the resource owners for the consumption of capital goods in the production process and likewise considered as a factor contribution. Depreciation allowance represents the fee for the present use of machines and equipment which have been installed in the past. The accumulated values from the past only accrue to the resource owners for reasons of re-investments. It should be noted that it is gradual use of capital goods as paid by the depreciation cost that should be considered as a factor contribution and not the total amount invested to purchase the said goods.

Example of GNP Computation using Expenditure and Income Approach:

Compute GNP 2005 using expenditure and income approach.
Given: GNP accounts in Millions

Personal Consumption Expenditure		Php2,565,200
Capital Formation (Investment Goods)	125,000	
Government Expenditure		628,000
Export		895,300
Import		903,200
Net Factor Income from abroad	(12, 500)	
Factor Income of Persons		Php1,850,800
Corporate Income		450,200
Government Income from Capital		734,600
Indirect Taxes		49,350
Subsidies		10,500
Capital Consumption Allowance		15,900

Gross National Product (GNP) Expenditure Approach

Personal Consumption Expenditure	(C)	Php2,565,200
Gross Domestic Capital Formation or Investment	(I)	125,000
Government Expenditures	(G)	628,000
		Php3,318,200

Export	Php895,300	
Less: Import	903,200	(7,900)
Statistical Discrepancy		(207,450)
Gross Domestic Product (GDP)		Php3,102,850
Net Factor Income from abroad (NFY)		(12,500)
Gross National Product (GNP)		**Php3,090,350**

Gross National Product (GNP) Income Approach

Income of Persons	(PY)		Php1,850,800
Corporate Income	(CY)		450,200
Government Income	(GY)		734,600
National Income	(NY)		Php3,035,600
Add: Indirect Taxes	(IT)		Php 49,350
Less: Subsidies	(S)	10,500	38,850
Depreciation Allowance	(DA)		15, 900
Gross National Product (GNP)			**Php3,090,350**

CHAPTER 9 EXERCISES

Name: ____ **Score:** __________________

Year/Course/Section: ____________________________ **Schedule:** ______________

I. Write **TRUE** if the statement is correct and **FALSE** if it is wrong.

____________ 1. Gross investment is the total output of investment goods.
____________ 2. Increases in a stock of goods of business firms constitute an addition to the economy's stock of productive instruments.
____________ 3. A negative statistical discrepancy means that GNP estimate of expenditures approach is understated.
____________ 4. Salary remittances of Filipinos working abroad constitute an inflow to our economy.
____________ 5. When export is lesser than import, unfavourable balance of trade experienced.
____________ 6. Profit remittances of foreign investors investing in our country contribute to positive net factor income from abroad.
____________ 7. Replacement investment is deducted from net investment.
____________ 8. A negative net factor income from abroad happens when import is greater than export.
____________ 9. Indirect taxes and depreciation are included in the final market prices of goods.
____________ 10. Import minus export is net export.

II. IDENTIFICATION

________________________ 1. An account used to even out the practical difference between the two approaches in GNP accounting.
________________________ 2. Direct pay for labor in an organized enterprise whether public or private.
________________________ 3. The sum total of factor income of persons, government income from capital and corporate income.
________________________ 4. The tax paid on the sale of production of product or service which is usually.
________________________ 5. The amount deducted from indirect tax which is also refers to the financial help granted by the government to public and private enterprises.
________________________ 6. The ration between a country's import to export.
________________________ 7. Fee for the present use of machines and building that have been installed in the past.
________________________ 8. These constitute the largest part of a nation's current flow of output.
________________________ 9. Component of GNP Accounting expenditure which refers to the goods which are used to produced more goods and services.
________________________ 10. The undistributed income of the corporations which are used for the company's expansion program or to boosts their operational capabilities.

MODULE 10- READING

CHAPTER X

BUSINESS ORGANIZATION

OBJECTIVES:

- Nature and Scope of Business Organization
- To determine different business organization according to its available resources;
- To identify the different partners in the business world;
- To learn about securities and bonds; and
- To understand what is the nature of cooperative

NATURE AND SCOPE OF BUSINESS ORGANIZATION

The term **business organization** describes how businesses are structured and how their structure helps them meet their goals. In general, businesses are designed to focus on either generating profit or improving society. When a business focuses on generating profits, it is known as a for-profit organization. When an organization focuses on improving the social good through the arts, education, health care, or some other area, it is known as a non-profit (or not-for-profit) organization and is not typically referred to as a business.

Business Organization is the combination business and organization. In order to understand the nature and importance of business organization, it is necessary that the meaning of these two words should be clear to everyone.

1) ***Business*** is a human activity, which is undertaken to provide goods and services to the people with a view to earn profit. Money flowing in and earning profit through the satisfaction of the customers are the two measuring rods of the success of a business.
2) ***Organization:*** **–** The words organization is generally divided into two parts.

1. Material Organization **2. Human Organization.**

Material Organization: – The material organization is the determining and provision of necessary raw materials, tools, capitals etc to enterprises for their smooth running and functioning.

Human Organization: – It is the appointment of qualified staff and assigning them different duties and responsibilities for the sake business organization interest. Organizations also give them enough authority to perform all their duties and responsibilities smoothly.

Now **business organization** can be defined as the process of establishing effective cooperation among different people to achieve certain goals to earn profit. Business organization can be formed to serve people and known as non-profit organization.

THREE (3) BASIC FORMS OF BUSINESS ORGANIZATION

One of the first decisions that you will have to make as a business owner is how the business should be structured. All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, life span, and financial structure. This decision will have long-term implications, so you may want to consult with an accountant and attorney to help you select the form of ownership that is right for you.

SOLE PROPRIETORSHIP

Sole proprietorship or individual entrepreneurship is a business concern owned and operated by one person. The sole proprietor is a person who carries on business exclusively by and for himself. He alone contributes the capital and skills and is solely responsible for the results of the enterprise. In fact sole proprietor is the supreme judge of all matters pertaining to his business subject only to the general laws of the land and to such special legislation as may affect his particular business.

Advantages of Sole Proprietorship:

- **Easy to form and wind up –** It is very easy and simple to form a sole proprietorship form of business organization. No legal formalities are required to be observed. Similarly, the business can be wound up any time if the proprietor so decides.

- **Quick Decision and Prompt Action** – Nobody interferes in the affairs of the sole proprietary organization. So he/she can take quick decisions on the various issues relating to business and accordingly prompt action can be taken.

- **Direct Motivation** – In sole proprietorship form of business organizations entire profit of the business goes to the owner. This motivates the proprietor to work hard and run the business efficiently.

- **Flexibility in Operations** – It is very easy to effect changes as per the requirements of the business. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organization.

- **Maintenance of Business Secrets** – The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts.

- **Personal Touch –** Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contact with customers and employees.

Disadvantages of Sole Proprietorship:

- **Limited Resources –** The resources of a sole proprietor are always limited. It is not always possible to arrange sufficient funds from personal sources.

- **Lack of Continuity** – The continuity of the business is linked with the life of the proprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain.

- **Unlimited Liability** – In the eyes of law, the proprietor and the business are one and the same. So personal properties of the owner can also be used to meet the business obligations and debts.

- **Unsuitable for Large Scale Operations** – As the resources and the managerial ability are limited, sole proprietorship form of business organization is not suitable for large- scale business.

- **Limited Managerial Expertise** – A sole proprietorship form of business organization always suffers from lack of managerial expertise. A single person may not be an expert in all fields like, purchasing, selling, financing etc.

Suitability of Sole Proprietorship:

In short, this is a simple one person firm where, one can use his brand name, apply for payment gateways and be able to issue invoice on his brand name to customers. It is best form for the testing of ideas in the starting stage whether it's an e-commerce or tech start-up, on later stage, one can easily set up another elaborate forms like private limited company or public limited company.

PARTNERSHIP

Partnership is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business, and share its profit. The persons who form a partnership are individually known as partners and collectively a firm or partnership. There are typical classifications of partnerships: general partnership, limited partnerships, and limited liability partnerships.

Advantages of Partnership:

- **Easy to Form** – partnership can be easily formed without expense and legal formalities. Even the registration of the firm is not compulsory.

- **Availability of Larger Resources** – when compared to sole proprietorship, the partnership will have larger resources. Hence, the scale of operations can be increased if conditions warrant it.

- **Better Decisions** – as partners meet very often, they take decisions regarding business policies very promptly. This helps the firm in taking advantage of changing business conditions.

- **Flexibility** – partnership is free from legal restriction for changing the scope of its business. The line of business can be changed at any time with the mutual consent of the partners. No legal formalities are involved in it.

- **Sharing of Risks** – The losses of the firm are shared by all the partners equally or as per the agreed ratio as decided in the partnership agreement.

- **Keen Interest** – Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.

- **Benefits of Specialization** – Partnership firm enjoys benefits of individual partners, specialization, for instance, in a partnership firm, providing legal consultancy to people, one partner may deal with civil cases, one in criminal cases, and another in labour cases and so on as per their area of specialization.

- **Protection of Interest** – In partnership form of business organization, the rights of each partner and his/her interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.

- **Secrecy** – Business secrets of the firm are only known to the partners.

Advantages of Partnership:

A partnership firm also suffers from certain limitations:

- **Unlimited Liability** – Partners in partnership firm suffer from the problem of unlimited liability. Resultantly, members may end up using personal assets to meet the liabilities of business.

- **Instability** – Every partnership firm has uncertain life. The death, insolvency, incapacity or the retirement of any partner bring the firm to an end. Not only that any dissenting partner can give notice at any time for dissolution of partnership.

- **Limited Capital** – A partnership firm suffers due to limited personal capacity of partners.

- **Non-transferability of share** – The share of interest of any partner cannot be transferred to other partners or to the outsiders.

- **Possibility of Conflicts** – At times there is a strong possibility of conflict among partners due to divergent views and interest. Some frictions, misunderstanding and lack of harmony may arise at any time which may ultimately lead to dissolution.

- **Tendency to play safe -** because of the principle of unlimited liability, the partners tend to play safe and pursue unduly conservative policies.

Suitability of Partnership:

Usually persons having different abilities, skill or expertise can join hands to form a partnership firm to carry on the business. Business activities like construction, providing legal services, accounting and financial services etc. can successfully run under this form of business organization.

It is also considered suitable where capital requirement is of a medium size. Thus, businesses like a wholesale trade, professional services, mercantile houses and small manufacturing units can be successfully organized as partnership firms.

<u>CORPORATION</u>

A **corporation** is a business entity that is owned by its shareholder(s), who elect a board of directors to oversee the organization's activities. The corporation is liable for the actions and finances of the business – the shareholders are not. Corporations can be for-profit, as businesses are, or not-for-profit, as charitable organizations typically are.

Advantages of Corporations

- **Limited liability for the owners** – Since a corporation is a separate and distinct legal entity, owners of a corporation are only indebted to the extent of their interest in the corporation. This means that the creditors of a corporation can only run after the assets of the corporation and not the personal assets of the stockholders in the settlement of the corporation's debts and obligations. In other words stockholders enjoy a "shield" from most creditors.

- **Ease on the sell and transfer** – If the stock of a corporation is publicly traded, owners and investors can sell their ownership interest in a corporation in a matter of minutes through a stockbroker. If the stock is not publicly traded, the stock certificate can be transferred or assigned to another owner by executing a deed of assignment of shares of stock.

- **Continuity** – The corporation's power of succession enables it to enjoy a continuous existence. Unlike a sole proprietorship, the death of a stockholder will not terminate the corporation. The corporation will continue as a separate and distinct legal entity and the shares of its interest can be transferred from one owner to another owner.

- **Ease in raising money** – Because of limited liability, ease of transfer of shares and continuity, investors are more attracted to investing in corporations rather than in sole proprietorships and partnerships. This attraction allows corporations to raise the capital needed to manage and expand their operations.

Disadvantages of Corporations

- **Complexity in Organization and Regulation** – To incorporate a business, an application with the Securities and Exchanges Commission must be filed and approved. A higher capital requirement is also sometimes required for other type of corporations. Once approved, the corporation must comply with the numbers of regulations and reportorial requirements which are specifically implemented for corporations.

- **Double Taxation** – A possibility of "double taxation" may arise on the dividends it pays. The corporation is taxed on its income. Then, if the corporation distributes some of the net income to the stockholders as dividend, the dividend will be taxed again on the stockholder's personal income tax returns.

- **Limited Liability may weaken credit capacity** – A corporation which doesn't have a good financial condition and performance may drive away creditors specially that owners are enjoying limited liabilities. This may weaken the corporation's capacity to borrow money to expand its operations.

- **Centralized Management** – Its centralized management restricts a more active participation stockholders who are not major owners in the conduct of corporate affairs.

COOPERATIVE

A cooperative, or co-op, as "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically controlled enterprise." In other words, cooperatives are created by people who have a specific need and who are willing to work together to operate and organize a company that will meet that need. Cooperatives are typically classified as either consumer cooperatives or workers cooperatives.

Universally Accepted Principles of Cooperative are the following:

1. Open and voluntary membership
2. Democratic control
3. Limited interest on capital
4. Division of net surplus
5. Cooperative education
6. Cooperation with other cooperatives

Objectives of Cooperatives

1. To encourage thrift and savings
2. To generate funds and extend credit
3. To encourage among members systematic production and marketing
4. To provide goods and services and other requirements to members
5. To develop expertise and skills among its members
6. To acquire lads and provide housing benefits for the members
7. To promote and advance the economic, social and educational status of the members
8. To establish, own lease or operate cooperative banks, cooperative whole sale and retail complexes, insurance and agricultural/industrial processing enterprises, and public markets.

Types of Cooperatives

- ***Credit cooperative***. Promotes thrift among its members and create funds in order to grant loans for productive and provident purposes.

- ***Consumers cooperative***. Procures and distributes commodities to its members and non-members.

- ***Producers cooperative***. Undertake joint production in agriculture and industry.

- ***Marketing cooperative***. Engages in the supply of production.

- ***Service cooperative***. Undertakes medical and dental care, labor, and other services.

- ***Multipurpose cooperative***. Combines two of more of the business activities of the different types of cooperative.

IMPORTANCE OF BUSINESS ORGANIZATION

- **Products Growth.** All business activities directed towards the production of goods and services in betterment of **business organization**.

- **Efficient Use of Resources.** Organizations play a vital role in the efficient use of factors of productions and other resources and thus reduced the cost of production of goods.

- **Technological Improvements.** A good organization provides for the optimum use of technologies improvements.

- **Creative thinking.** It stimulates independence creative thinking in various departments of production.

- **Use of skilled salesman.** Another importance of business organization is that it is very useful in providing skilled salesmanship for satisfying the various needs of the customers.

- **Quick decisions.** The business organization makes easy to take quick decisions.

- **Recognition of the problem.** The recognition of the problem, selection of the solution, issuing of the necessary orders can be taken in the right time.

- **Fixing of responsibility.** One of the most important things of business organization is that fixing of responsibility can easily be pin pointed.

- ❖ **Feed back.** An organization makes it possible to take decisions in the right time about production and thus may take feedback. Before making any decision organization always research the market and combine the facts.

- ❖ **Minimum cost.** The organizations always try to attain the goals and objectives of the business at the minimum cost.

Characteristics of an ideal form of Business organization

Before undertaking a description of the various forms of organization and their respective merits and weaknesses it will be desirable to refer to the features which make for an ideal form of business organization.

These characteristics will be found applicable to the various forms of organization in varying degrees. In choosing a particular form of organization an entrepreneur will try to find out how far his requirements will be met by a particular form of organization. The following factors will be taken into account.

- ***Ease of formation***. It should be easy to form the organization. The formation should not involve many legal formalities and it should not be time consuming.

- ***Adequacy of Capital***. The form of organization should facilitate the raising of the required amount of capital at a reasonable cost. If the enterprise requires a large amount of capital, the preconditions for attracting capital from the public are ***a) safety investment b) fair return of investment and c) transferability of the holding.***

- ***Limit of Liability***. A business enterprise may be organized on the basis of either limited or unlimited liability. From the point of view of risk, limited liability is preferable. It means that the liability of the owner as regards the debts of the business is limited only to the amount of capital agreed to be contributed by him. Unlimited liability means that even the owners' personal assets will be liable to be attached for the payment of the business debts.

- ***Direct Relationship between Ownership***, Control and Management. The responsibility from management must be in the hands of the owners of the firm. If the owners have no control on the management, the firm may not be managed efficiently.

- ***Continuity and Stability***. Stability is essential for any business concern. Uninterrupted existence enables the entrepreneur to formulate long-term plans for the development of the business concern.

- ***Flexibility of Operations***. Another ideal characteristic of a good form of organization is flexibility of operations. Changes may take place either in market conditions or the states' policy toward industry or in the conditions of supply of various factors of production. The nature of organization should be such as to be able to adjust to the changes without much difficulty.

TYPES OF BUSINESS OPERATIONS

A business entity is an organization that uses economic resources to provide goods or services to customers in exchange for money or other goods and services.

Business organizations come in different types and in different forms of ownerships.

1. Service Business

A service type of business provides intangible products *(products with no physical form)*. Service type firms offer professional skills, expertise, advice, and other similar products.
Examples of service businesses are: salons, repair shops, schools, banks, accounting firms, and law firms.

2. Merchandising Business

This type of business buys products at wholesale price and sells the same at retail price. They are known as "buy and sell" businesses. They make profit by selling the products at prices higher than their purchase costs.
A merchandising business sells a product without changing its form. Examples are: grocery stores, convenience stores, distributors, and other resellers.

3. Manufacturing Business

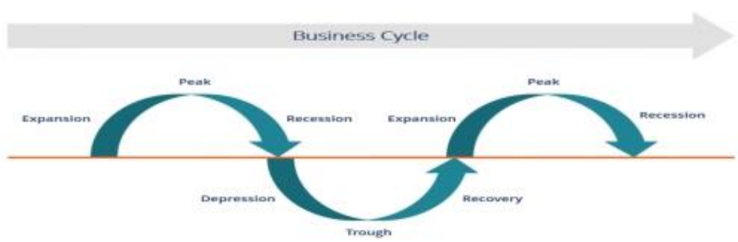
Unlike a merchandising business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased. A manufacturing business combines *raw materials, labor, and overhead costs* in its production process. The manufactured goods will then be sold to customers.

WHAT IS THE BUSINESS CYCLE?

The term "business cycle" (or economic cycle or boom-bust cycle) refers to economy-wide fluctuations in production, trade, and general economic activity. From a conceptual perspective, the business cycle is the upward and downward movements of levels of GDP (gross domestic product) and refers to the period of expansions and contractions in the level of economic activities (business fluctuations) around a long-term growth trend.

These fluctuations in the economic activities are termed as phases of business cycles.

The fluctuations are compared with ebb and flow. The upward and downward fluctuations in the cumulative economic magnitudes of a country show variations in different economic activities in terms of production, investment, employment, credits, prices, and wages. Such changes represent different phases of business cycles.



Stages of the Business Cycle

In the diagram above, the straight line in the middle is the steady growth line. The business cycle moves about the line. Below is a more detailed description of each stage in the business cycle:

#1 Expansion

The first stage in the business cycle is expansion. In this stage, there is an increase in positive economic indicators such as employment, income, output, wages, profits, demand, and supply of goods and services. Debtors are generally paying their debts on time, the velocity of the money supply is high, and investment is high. This process continues as long as economic conditions are favorable for expansion.

#2 Peak

The economy then reaches a saturation point, or peak, which is the second stage of the business cycle. The maximum limit of growth is attained. The economic indicators do not grow further and are at their highest. Prices are at their peak. This stage marks the reversal point in the trend of economic growth. Consumers tend to restructure their budgets at this point.

#3 Recession

The recession is the stage that follows the peak phase. The demand for goods and services starts declining rapidly and steadily in this phase. Producers do not notice the decrease in demand instantly and go on producing, which creates a situation of excess supply in the market. Prices tend to fall. All positive economic indicators such as income, output, wages, etc., consequently start to fall.

#4 Depression

There is a commensurate rise in unemployment. The growth in the economy continues to decline, and as this falls below the steady growth line, the stage is called depression.

#5 Trough

In the depression stage, the economy's growth rate becomes negative. There is further decline until the prices of factors, as well as the demand and supply of goods and services, reach their lowest point. The economy eventually reaches the trough. It is the negative saturation point for an economy. There is extensive depletion of national income and expenditure.

#6 Recovery

After this stage, the economy comes to the stage of recovery. In this phase, there is a turnaround from the trough and the economy starts recovering from the negative growth rate. Demand starts to pick up due to the lowest prices and, consequently, supply starts reacting, too. The economy develops a positive attitude towards investment and employment and production starts increasing.

Employment begins to rise and, due to accumulated cash balances with the bankers, lending also shows positive signals. In this phase, depreciated capital is replaced by producers, leading to new investments in the production process.

Recovery continues until the economy returns to steady growth levels. It completes one full business cycle of boom and contraction. The extreme points are the peak and the trough.

CHAPTER 10 EXERCISES

Name: ____ **Score: _________________**

Year/Course/Section: ____________________________ **Schedule: _____________**

I. Identification:

Direction: Fill in the blank before each number with the correct answer.

_____________________ 1. A process or an art establishing effective cooperation between the factors of production for producing or acquiring wealth with view to earn profit in an enterprise.
_____________________ 2. A human economic activity which involves continuously and regular production of goods and services with a view to earn profit.
_____________________ 3. Form of business owned by one person.
_____________________ 4. Form of business with two or more people operates for the common goal of making profit.
_____________________ 5. It promotes thrift among its members and creates funds in order to grant loans for productive and provident purposes.
_____________________ 6. This type of cooperative combines two or more of the business activities of the different types of cooperative.
_____________________ 7. The form of organization should facilitate the raising of the required amount of capital at a reasonable cost.
_____________________ 8. This type of business operation provides services, instead of product to its customer.
_____________________ 9. This type of business operation converts basic inputs, such as materials, labor, and overhead into finish products which are sold to customers.
_____________________ 10. This business is a periodic but irregular up-and-down movement in economic activity measured by fluctuation in real GDP and other macroeconomic variables.

II. Enumeration:

Direction: Enumerate and discuss the following briefly. Use the space provided after each number.

1-6. Stages of Business Cycle.

1.
2.
3.
4.
5.
6.

7-12. Characteristics of an Ideal Form of Business

7.
8.
9.
10.
11.
12.

13-17. Importance of Business Organization

13.
14.
15.
16.
17.

18-21. Advantages and Disadvantages of Sole Proprietorship

18.
19.
20.
21.

22-25. Advantages and disadvantages of Partnership.

22.
23.
24.
25.

MODULE 11 - READING

CHAPTER XI

TAXATION

OBJECTIVES:

To know the meaning of Taxation

- To give importance of Taxation
- To differentiate the classification of Taxation; and
- To learn the proper computation in filing individual income tax.

TAXATION

Taxes are the enforced proportional contributions levied by the law-making body of the state by virtue of its sovereignty upon the persons of property within its jurisdiction for the support of the government and all public need.

As State Power refers to the inherent power if the state exercised through its legislature to impose or levy a proportionate burdens upon persons, property, rights or transactions to raise revenue to support and maintain government expenditure, and for general and economic welfare.
As a Process refers to the act of imposing a tax by a sovereign state to raise revenue for the use and support of the government.

Taxation is a system of payment that individuals and businesses are required to pay the government.

As stated by De Leon (2005, p 375), taxes ought to possess the following characteristics:

Enforced Contribution. Due to the critical role taxes play in a state, a tax cannot be imposed as a voluntary contribution or donation. All citizens, with respect to their ability, have to pay taxes. The National Internal Revenue Code of the Philippines (Republic Act 8284).
Payable in Money. A tax must be discharged alone in money which must be in legal tender.
Proportionate in Character. Taxes are based on the ability to pay.
Imposed on person or property. A tax may be imposed on acts, transactions, or contracts. For example, a person will pay taxes for his income and owned estates.
Imposed by the state which has jurisdiction over the person or property. The state cannot apply its power of taxation to individuals or entities outside its legal jurisdiction.

Imposed by the law-making body of the state. Although taxation is considered to be an inherent power of the state, its imposition must be anchored on the enactment of statutes and ordinances made by the Legislative branch of the government.
It is levied for public purposes. Taxation involves and a tax constitutes, a charge of burden imposes to provide income for public purposes – the support of the government, the administration of the law, or the payment by public expense.

Kinds of Taxes under Existing Laws
As to who bears the burden?

a. Direct Taxes – These are paid and shouldered directly by the taxpayer to a tax collecting agency of the government.

Example: Income Taxes (Corporations or Individuals)
Residence tax, Community tax, Real estate tax, Immigration tax,
Gifts and Inheritance taxes.

b. Indirect Taxes – These are paid by the taxpayer but which he can shift or pass on to others, particularly those who avail of his goods and services. A good example of this would be the value-added-tax (VAT), which are passed on by the manufacturers to consumers increasing the cost of their goods. Another example would be the customs duties or tariffs imposed on imported merchandise.

Example: Sales taxes, Amusement tax, EVAT

2. As to Subject Matter or Object:

- **Personal, Poll or Capitation Tax**. Refers to a tax of fixed amount imposed on an individual residing within a specified territory, whether a citizen or not, and regardless of property or occupation they engaged in (e.g., community tax)

- **Property Tax.** Refers to the amount imposed on property, whether real or personal, in proportion either to its value of in accordance with some other reasonable method or apportionment (e.g., real estate tax).

- **Excise Tax.** Refers to any which does not fall within the classification of a poll tax or a property tax. It is charged or imposed upon the performance of an act, the enjoyment of a privilege and in engaging an occupation. (e.g., estate, donors, and income taxes: value-added tax or VAT, and practically all business taxes).

3. As to Determination of Amount:
Specific – tax of a fixed amount imposed by the head or number, or by standard weight or measurement; it requires no assessment other than a listing or classification of the objects to be taxed.

Examples: distilled spirits, cigars, cigarettes

- **Ad Valorem -** tax of a fixed proportion of the amount or value of the property with respect to which the tax is assessed.

Examples: real estate tax most custom duties, income tax, excise tax on automobiles and non-essential goods.

As to Purpose:

- **General, Fiscal or Revenue** – tax imposed for the general purposes of government i.e., to raise revenues for governmental needs.

Examples: income tax, taxes on businesses

Special or Regulatory – tax imposed for a special purpose, i.e., to achieve some social or economic ends irrespective of whether revenue is actually raised or not.
Examples: protective tariffs on imported goods.

As to Authority Imposing the Tax:

- **National** – tax imposed by the national government.

Examples: national internal revenue taxes – income tax, custom duties, national taxes imposed by special law.

Municipal of Local – tax imposed by municipal corporations of local governments.
Examples: real estate tax, tax on occupations.

6. As to Graduation or Rate:

- **Proportional** – tax based on a fixed percentage of the amount of the property, income or other basis to be taxed.

Examples: real estate tax, value-added tax, other percentage taxes.

- **Progressive of Graduated** – the rate of which increases as the tax base increases.

Examples: income tax, estate tax, donor's tax.

- **Regressive -** the rate of which decreases as the tax base increases. We have no regressive taxes.

Tariff explained by these three ideas:

A. Book with alphabetical listing of several lands and merchandise together with their corresponding payments.
B. Duties payable on goods imported or exported.
C. System or principle of imposition of custom duties.

Tax Exemption – The government exempt the following in order to encourage and promote their growth:
Cooperatives
Cottage Industries
Organizations or institutions engaged in non-profit undertakings:

religious, charitable, scientific, athletic or cultural purposes;
donations to social welfare, cultural and charitable institutions;
social security benefits, retirement gratuities, pensions and other similar benefits received by retired employees; and benefits received by members of GSIS.

System of Taxation

Progressive Tax System – the tax rate tend to increase with the increase in the tax base. Usually associated with direct taxes and is normally accepted to be the ideal system since it taxes the people according to their ability to pay. The Philippines is under this system. By imposing more progressive taxes, it takes more money away from the rich and less from the poor; it in effect increases the disposable income of the consumer.

Regressive Tax System – where tax rates are high for low bases, and decrease for high bases. This system is described as onerous since those with greater ability to pay are taxed less and the poor people with less ability to pay are taxed more. This system is normally associated with indirect taxes. The ease of collecting indirect taxes made the government highly dependent to them that have prevented them to abolish such system even if it is unjust.

Proportional Tax System – imposes a uniform tax rate on all income levels. If the government sets a tax rate of 10%, the taxpayer who earns Php50,000 pays a tax of Php5,000 and the one who earns Php100,000 pays a tax of Php10,000.

Characteristics of Taxation

As indicated above, they are enumerated below.

(1) It is an enforced contribution. – A tax is not a voluntary payment or donation and its imposition is in no way dependent upon the will or assent, open or implied, of the person taxed To be sure, taxation without representation, or without the consent in some form of those who are to be taxed, is contrary to the fundamental principles of good government. The principle of representation, however, applies only to political communities, as such, and not to individuals.

(2) It is generally payable in money. – Unless qualified by law (e.g., backpay certificates under Sec. 2, R.A No. 304, as amended.), the term “taxes” or “tax” is usually understood to be a pecuniary burden – an exaction to be discharged alone in the form of money which must be in legal tender.

(3) It is proportionate in character. – A tax is laid by some rule of apportionment according which persons share the public burden. It is ordinarily based on ability to pay. Thus, in practice, some people pay very high taxes; others, very small amounts or none at all.

(4) It is levied on persons or property. – A tax may also be imposed on acts, transactions, rights or privileges. In each case, however, it is only a person who pays the tax. The property is resorted to for the purpose of ascertaining the amount of tax that must be paid and of enforcing payment in case default of the taxpayer. But not all who pay a tax shoulder the burden of the tax.

(5) It is levied by the state which has jurisdiction over the person or property. – The object to be taxed must be subject to the jurisdiction of the taxing state. This is necessary in order that the tax can be enforced. Although a state can tax all persons subject to its jurisdiction for all their property left by them within its jurisdiction to seize upon person or property for purposes of taxation.

(6) It is levied by the law-making body of the state. – The power to tax is a legislative power which under the Constitution only Congress can exercise through the enactment of tax statutes. Accordingly, the obligation of a tax is statutory liability.

(7) It is levied for public purpose or purposes. – Taxation involves, and a tax constitutes, s charge or burden imposed to government, the administration of the law, or the payment of public expenses. Revenues derived from taxes cannot be used for purely private purposes or for the exclusive benefit of private persons.

Basic Characteristics of a Sound Tax System (Key FAT)
A sound tax system must be:

1. **Fiscal Adequacy** is the source of revenue must be adequate or enough to defray the expenses of the government.
2. **Administrative Feasibility** must meet the following criteria:
    - Tax laws must clear and concise
    - It is capable of proper enforcement
    - It is not burdensome
3. **Theoretical Justice** is a tax that must be used on the ability to pay.

Classification of Taxes

1. As to subject matter or object:

***A. personal, poll or capitation*-** tax of a fixed amount on individuals residing within a specified territory, without regard to their property, occupation or business. Ex. Community tax (basic)

***B. property*-** imposed on property, real or personal, in proportion to its value, or in accordance with some reasonable method or apportionment. Ex. Real estate Tax

***C. Excise*-** imposed upon the performance of an act, the enjoyment of a privilege, or the engaging in an occupation, profession or business. Ex. Income tax, VAT, Estate Tax, Donor's Tax

2. As to who bears the burden of the tax:

***a. Direct*-** the tax is imposed on the person who also bears the burden thereof
Ex. Income tax, community tax, estate tax
b. Indirect – imposed on the taxpayer who shifts the burden of the tax to another, Ex. VAT, customs duties.

3. As to determination of amount:

a. specific – imposed and based on a physical unit of measurement as by head number, weight, length or volume. Ex. Tax on distilled spirits, fermented liquors, cigars

b. Ad Valorem of a fixed proportion of the value of the property with respect to which the tax is assessed. Ex. Real estate tax, excise tax on cars, non-essential goods.

As to purpose:

A. general, fiscal, or revenue- imposed for the general purpose of supporting the government. Ex. Income tax, percentage tax

B. special or regulatory- imposed for a special purpose, to achieve some social or economic objective. Ex. Protective tariffs or custom duties on imported goods intended to protect local industries.

5. As to scope or authority imposing the tax:

a. national- imposed by the national government ex. NIRC, custom duties.
b. municipal or local- imposed by municipal corporations or local governments ex. Real estate tax.

6. As to graduation of rates:

a. Proportional- based on a fixed percentage of the amount of the property, receipts or on other basis to be taxed ex. Real estate tax, VAT
b. Progressive and graduated- the rate of the tax increases as the tax base or bracket increases ex. Income tax, estate tax, donor's tax
c. Regressive- the rate of tax decreases as the tax base or bracket increases.

FORMS OF ESCAPE FROM TAXATION•

Shifting• B. Capitalization• C. Transformation• D. Avoidance• E. Exemption• F. Evasion

A. SHIFTING• process by which tax burden is transferred from statutory taxpayer to another without violating the law.• One way of passing the burden of the tax from one person to other. For Example, taxes paid by the manufacturer may be shifted to the consumer by adding the amount of the tax paid to the price of the product.

Kinds of Shifting•

1. Forward shifting- when burden of tax is transferred from a factor of production through the factors of distribution until it finally settles on the ultimate purchaser or consumer.

2. Backward shifting – when the burden is transferred from consumer through factors of distribution to the factors of production;
3. Onward shifting- when the tax is shifted 2 or more times either forward or backward.

B. CAPITALIZATION• the reduction in the price of the taxed object equal to the capitalized value of the future taxes which the purchaser expects to be called upon to pay. This refers to the reduction in the price of the taxed object to the capitalize value of future taxes which the purchaser expects to be called upon to pay. An example as the reduction made by the seller on the price of the Real Estate, in anticipation of the future tax to be shouldered by the future buyer.

C. TRANSFORMATION• the manufacturer or producer upon whom the tax has been imposed, fearing the loss of his market if he should add the tax to the price, pays the tax and endeavors to recoup himself by improving his process of production thereby turning out his units at a lower cost. Occurs when the manufacturer or the producer upon whom the tax has been imposed pays the tax and endeavor to "recoup" himself/herself by improving his/her process of production.

D. TAX AVOIDANCE• exploitation by the taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income, in order to avoid or reduce tax liability. The exploitation by the taxpayer of legally permissible methods in order to avoid or reduce tax liability. This is also known as "tax minimization". An example is exhausting and/or utilizing all allowable deductions in law to lessen or reduce the tax burden.

E. TAX EXEMPTION• grant of immunity to particular persons or corporations of a particular class from a tax which persons and corporations generally within the same state or taxing district are obliged to pay. The grant of immunity or freedom from financial charge, obligation, or burden to which others are subjected.

GROUNDS FOR TAX EXEMPTION

a) Contract, wherein the government is the contracting party b) Public policy c) Reciprocity

F. TAX EVASION• The practice by the taxpayer through illegal or fraudulent means to defeat or lessens the amount for tax. This is also known as "tax dodging". Tax evasion presupposes malice, fraud, bad faith, or wilful intent on the part of taxpayer as in the case of substantial under declaration of income for four (4) consecutive years. An example is the deliberate and/or malicious failure to report income to defeat tax liability.

INDICIA OF FRAUD IN TAX EVASION Indicia of Fraud in tax evasion• **1**. Failure to declare for taxation purposes true and actual income derived from business for 2 consecutive years;• **2.** Substantial under declaration of income tax returns of the tax payer for 4 consecutive years coupled with intentional overstatement of deductions.

Definition of Taxpayers Classification

1. Single Person – Including a married person judicially decreed as legally separated from his or her spouse with no qualified dependents.

2. Head of the Family – an individual who actually supports and maintains one household one or more individuals, who are closely connected with him by blood relationship, relationship by marriage or by adoption and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligations.

Under the **Tax Code**, the term means an unmarried or legally separated man or woman with:

One or both parents, or
One or more brothers or sisters, or
One or more legitimate, recognized natural, or legally adopted children, living with and dependent upon him or her for their chief support.

A Recognized Natural Child – is one borne outside wedlock between a man and woman who at the time of the conception of the child were free to marry each other and is recognized by one or both parents.

3. Married Persons – Man or woman not legally separated from his or her spouse, if both of them are earning they are allowed an exemption of P32,000 each or a total of P64,000. Only one of the spouses shall claim the additional exemption for children.

Additional Exemption for Dependents – P8,000 for each dependent child not to exceed four (4) with the following pre-requisites:

1. The child is legitimate, illegitimate, legally adopted child.
2. The child is living with the taxpayer, chiefly dependent for support.
3. The child is not more than 21 years of age.
4. The child is not gainfully employed or incapable of self-support because of mental or physical defect even if over 21 years of age.

Gross Income – means all income derived from whatever source.

Types of Gross Incomes:

Gross income includes, but not limited to the following:

- Compensation for services, in whatever form paid, including but not limited to fees, salaries, wages, commissions and similar item.
- Gross income derived from the conduct of trade or business or the exercise of professions.
- Gains derived from dealings in property
- Interest
- Rents
- Royalties
- Dividends
- Annuities
- Prizes and winnings
- Pensions
- Partner’s distributive

Exclusions from Gross Income:

a. Life Insurance
b. Amount received by insured as return of premium
c. Gifts, bequests or devises
d. Compensation for injuries or sickness
e. Income exempt under treaty
f. Retirement benefits, pensions, gratuities, etc.
g. Miscellaneous items like:

- Income derived by foreign government
- Income derived by the government or its political subdivision
- Prizes and awards in sport competition
- Prizes and awards which met the conditions set in the Tax Code
- 13^{th} month pay and other benefits
- GSIS, SSS, Medicare and other contributions
- Gain from the sale of bonds, debentures or other certificate of indebtedness
- Gain from redemption of shares in mutual fund

Allowable Deductions from Gross Income

Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationships where the only deduction provided that the gross family income does not exceed P250,000 per family is the premium payment on health and/or hospitalization insurance, a taxpayer may opt to avail any of the following gross income:

Optional Standard Deduction – an amount not exceeding 40% of the net sales for individuals and gross income for corporations; or

Itemized Deductions – which include the following:

- Expenses
- Interest
- Taxes
- Losses
- Bad Debts
- Depreciation
- Depletion of Oil and Gas Wells and Mines
- Charitable Contributions and other Contributions
- Research and Development
- Pension Trusts

In addition, individuals who are either earning compensation income, engaged in business or deriving income from the practice of profession are entitled to personal and additional exemptions as follows:

Personal Exemptions:

For single individual or married individual judicially decreed as legally separated with no qualified dependents …………………………………………… P50,000.00
For head of the Family ………………………....…… P50,000.00
For each married individual* …………...................... P50,000.00
Note: In case married individuals where only one of the spouses is deriving gross income, only such spouse will be allowed to claim the personal exemption.

Additional Exemptions:

For each qualified dependent, a P25,000 additional exemption can be claimed but only up to 4 qualified dependents.

The additional exemption can be claimed by the following:
The husband who is deemed the head of the family unless he explicitly waives his right in favour of his wife.

- The spouse who has custody of the child or children in case of legally separated spouses. Provided, that the total amount of additional exemptions that may by claimed by both shall not exceed the maximum additional exemptions allowed by the Tax Code.
- The individuals considered as Head of the Family supporting a qualified dependent.

The maximum amount of P2,400 premium payments on health and/or hospitalization insurance can be claimed if:

- Family gross income yearly should not be more than P250,000.

- For married individuals, the spouse claiming the additional exemptions for the qualified dependents shall be entitled to this deduction.

Computing Income Tax:

Example: thus if the taxable income is P35,000, the income tax payable is:

Up to P30,000 ………………………….……..… P2,500.00
15% x P5,000 ……………………………..…… +P 750.00
= P3,250.00 (income tax)

Rates of Taxable Income on Individuals

The following are the rates:

Not over P10,000 5%

Over	P10,000 but not over P30,000	P5,000+	10% of the excess over P10,000
Over	P30,000 but not over P70,000	P2,500+	15% of the excess over P30,000
Over	P70,000 but not over P140,000	P8,500+	20% of the excess over P70,000
Over	P140,000 but not over P250,000	P22,500+	25% of the excess over P140,000
Over	P250,000 but not over P500,000	P50,000+	30% of the excess over P250,000
Over	P500,000	P125,000+	34% of the excess over P500,000

- **Estate and Inheritance Tax** – estate tax is tax on the right of the deceased person to transmit his estate to his lawful heirs on beneficiaries while inheritance tax is tax on the right to of the heirs or beneficiaries to receive the estate of the deceased person.

- **Donor's Tax** – it can be ***inter vivos*** (if made between living persons, to take effect during the lifetime of the donor) and ***mortis causa*** (if made in the nature of a testamentary disposition, that is, shall take effect upom the death of the donor).

- **Value-Added-Tax** – is a form of sales tax. It is a tax on consumption levied on the sale, barter, exchange or lease of goods or properties and services in the Philippines. It is an indirect tax, which may be shifted or passed on to the buyer, transferee or lessee of goods, properties or services.

Person Required to File VAT Returns

Any person or entity who, in the course of his trade or business, sells, barters, exchanges. Leases goods or properties and renders services subject to VAT, if the aggregate amount of actual gross sales or receipt exceed One Million Five Hundred Thousand Pesos (P1,500,000.00)

- A person required to register as VAT taxpayer but failed to register.
- Any person, whether or not made in the course of his trade or business, who imports goods.

- **Excise Tax** – is a tax imposed on certain specified goods manufactured of produced in the Philippines for domestic sale or consumption or for any other disposition and to goods imported in the Philippines.

- **Documentary Stamp Tax** – is a tax on documents, instruments, and papers evidencing the acceptance, assignment, sale or transfer of an obligation, right of property incident thereto.

The following are, among others, the nation taxes imposed by special law.

a. Customs Duties – are taxes levied by the government on the importation of exportation of goods in or out of the country.

b. Travel Tax – tax imposed to lessen the restriction on foreign travel, simplify travel regulations and at the same time to provide adequate funds for government programs.

Schedule of the Travel Tax

P2,700.00 on passengers travelling under first class passage.
P1,620.00 on passengers travelling under economy class passage.
P1,350.00 (for first class passage) and P810.00 (economy passage) to those persons listed below:

1. Filipinos who are 12 years or below but not over 2 years.
2. Filipino journalists
3. Authorized by President for reasons of national interest.

Persons Exempted to Tax

4. Foreign Diplomats
5. Crew members of ships and airplanes
6. Infants 2 years below
7. OFW'S
8. Officials of the U.N.
9. Students with government approved scholarship

c. Energy Tax – taxes are imposed to discourage the uneconomic consumption of fuel and the need or additional revenues to support economic development

On Aircraft – based on the gross weight in kilos
On Watercraft – based of the length of the vessel

Electric Power Consumption – tax imposed on the monthly electric power consumption of every residential customer.

d. Private Motor Vehicle Tax – the tax was issued to rationalize the structure of the tax on private motor vehicles by basing the same on ability to pay of the owners.

INCOMES SUBJECT TO FINAL INCOME TAX

- **Royalties-** (except from books, literary works and musical compositions – 10%) prizes; other winnings; interest from bank deposits; yields of other monetary benefit from deposit substitutes (interest on money market placements); and yield or other monetary benefit from trust funds and similar arrangements – 20%; prizes amounting to P10,000 or less are to be included in taxable income and taxable accordingly. Winnings from Philippine Charity Sweepstakes and lotto are exempt from income tax.

- **Cash and property dividends received from a corporation** – 6%, 8% and 10%, effective 1998, 1999, and 2000 respectively.

- **Net capital gains from sale of shares of stocks not traded through the stock exchange** – 5% of the same amount not exceeding P100,000 and 10% on any amount in excess of P100,000.

- **Capital gains from the sale of real property** – 6% based on the gross selling price or current fair market value, whichever is higher.

CHAPTER 10 EXERCISES

Name: ____ **Score:** __________________

Year/Course/Section: ____________________________ **Schedule:** ______________

ASSIGNMENT AND ASSESSMENT

I. Identification:

Direction: Fill in the blank before each number with the correct answer.

________________________ 1. The inherent power of the state, acting through the legislature to impose and collect revenues to support the government and its recognized objects.
________________________ 2. Type of taxes that are paid and shouldered by the taxpayer.
________________________ 3. This type of taxes are is paid by the taxpayer which she/he can shift or pass on to others, goods example of this would be value-added tax. (VAT).
________________________ 4. It refers to a tax of fixed amount imposed on an individual residing within a specified territory.
________________________ 5. Refers to any tax which does not fall within the classification of a poll tax or property tax.
________________________ 6. It is referred to us as the incidence of taxation.
________________________ 7. This is based on the reciprocal duties of protection and support between the states and its inhabitants.
________________________ 8. A fixed proportion of the value of the property with respect to which the tax is assessed.
________________________ 9. Refers to those that restrict the power although they are not embodied I the constitution.
________________________ 10. Taxes that are implied by the National Government under the National Internal Revenue Code and other laws particularly the tariff and Customs Code.
________________________ 11. The amount of personal and additional exemptions allowed for single individual.
________________________ 12. This principle states that the burden must be shouldered by those who enjoy benefits and services.
_________________________ 13. Refers to the amount imposed on property, whether real or personal.
_________________________ 14. Refers to the rate decreases as the tax base or bracket increases.
_________________________ 15. Refers to those that restrict the power although they are not embodied in the constitution.

II. Enumeration:

Direction: Give the classification of taxation as to:

A. Subject matter

1.
2.
3.

B. Who bears the burden

1.
2.

C. Determination of the amount

1.
2.

D. Purpose

1.
2.

E. Authority imposing tax

1.
2.

F. Graduation or rate

1.
2.
3.

C. Explain why we need taxation.

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