PNU University

English in Economics and Management

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دانشگاه پیام‌نور **گروه اقتصاد**

۱۶۲۶ **(۱۹/آ)**

سرشناسه	: بافنده ایمان دوست، صادق ، ۱۳۴۸--
	Bafandeh Imandoost, Sadegh
عنوان و نام پدیدآور	:English in economics and management/ Sadegh Bafandeh Imandoust
مشخصات نشر	:تهران: دانشگاه پیام نور، ۱۳۸۹ =۲۰۱۰م.
مشخصات ظاهری	: ,VI۲۰۳ ص.
فروست	:دانشگاه پیام نور؛۱۶۲۶.گروه اقتصاد؛ ۱۹/آ
شابک	:978-964-387-662-3
وضعیت فهرست نویسی	:فیپا
یادداشت	:انگلیسی
یادداشت	:ع. به فارسی: زبان تخصصی اقتصاد و مدیریت
یادداشت	:واژه نامه
آوانویسی عنوان	:اینگلیش این اکانامیکس...
موضوع	:زبان انگلیسی -- کتاب‌های قرائت -- اقتصاد -- آموزش برنامه‌ای
موضوع	:زبان انگلیسی -- کتاب‌های قرائت -- مدیریت-- آموزش برنامه‌ای
شناسه افزوده	:غفاری، هادی، ۱۳۴۶--
شناسه افزوده	:Ghafari, Hadi
رده بندی کنگره	: ۱۳۸۹ ۲ب۷الف/PE۱۱۲۷
رده بندی دیویی	:۴۲۸/۶۴۰۲۴۳۳
شماره کتابشناسی ملی	:۲۰۴۰۸۶۵

English in Economics and Management

زبان تخصصی اقتصاد و مدیریت

دکتر صادق بافنده ایمان دوست

ویراستار علمی: دکتر هادی غفاری

تهیه و تولید: مدیریت تولید محتوا و تجهیزات آموزشی

چاپ و صحافی: انتشارات دانشگاه پیام‌نور

تعداد: * * *

چاپ..........،۱۳۸۹

قیمت: * * *

بسم الله الرحمن الرحیم

پیشگفتار ناشر

کتاب‌های دانشگاه پیام نور حسب مورد و با توجه به شرایط مختلف یک درس در یک یا چند رشتهٔ دانشگاهی، به‌صورت کتاب درسی، متن آزمایشگاهی، فرادرسی، و کمک‌درسی چاپ می‌شوند.

کتاب درسی ثمرهٔ کوشش‌های علمی صاحب اثر است که براساس نیازهای درسی دانشجویان و سرفصل‌های مصوب تهیه و پس از داوری علمی، طراحی آموزشی، و ویرایش علمی در گروه‌های علمی و آموزشی، به چاپ می‌رسد. پس از چاپ ویرایش اول اثر، با نظرخواهی‌ها و داوری علمی مجدد و با دریافت نظرهای اصلاحی و متناسب با پیشرفت علوم و فناوری، صاحب اثر در کتاب تجدیدنظر می‌کند و ویرایش جدید کتاب با اعمال ویرایش زبانی و صوری جدید چاپ می‌شود.

متن آزمایشگاهی (م) راهنمایی است که دانشجویان با استفاده از آن و کمک استاد، کارهای عملی و آزمایشگاهی را انجام می‌دهند.

کتاب‌های فرادرسی (ف) و **کمک‌درسی** (ک) به منظور غنی‌تر کردن منابع درسی دانشگاهی تهیه و بر روی لوح فشرده تکثیر می‌شوند و یا در وبگاه دانشگاه قرارمی‌گیرند.

مدیریت تولید محتوا و تجهیزات آموزشی

Acknowledgments

I would like to express my appreciation to the editor, Dr Hadi Ghaffari, for his precious comments and help. Also my thanks go to Professor Ahmad Jafari Samimi who encouraged me to improve my English knowledge when I was his student in Mazandaran University. I should mention here that I am responsible for any mistake in this book so any useful comments and corrections would be appreciated. (imandoust@pnu.ac.ir)

Sadegh Bafandeh Imandoust

Brief Contents

Preface

My goal in writing this text is to encourage the students of economics, management and accounting to develop their reading and comprehension skills. The text does this by informing students with the core concepts of economics, management and accounting.

The reading passages have been taken from basic text books sources. Care has been taken to include various topics from economics, management and accounting. Short passages have also been provided which should be translated into Persian.

Most of the chapters are allocated to the economic issues (except chapters 8, 9 and 10), because the students of Accounting and Management have sufficient English courses in the later semesters.

Chapter 1

The Nature of Economics

General Objectives

This unit has been designed to help you to:

- Discuss the difference between microeconomics and macroeconomics.
- Evaluate the role that rational self-interest plays in economic analysis.
- Explain why economics is a science.
- Distinguish between positive and normative economics.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

ALLOCATION **n**

The process of distributing resources for the production of goods and services, and of distributing goods and services for consumption by households.

An **allocation** is efficient if the resources, goods, and services are distributed according to the economy's highest valued uses.

BEHAVIORAL ECONOMICS n

An approach to the study of consumer behavior that emphasizes psychological limitations and complications that potentially interfere with rational decision making.

The typical person about whom economists make **behavioral economics** predictions is assumed to act as thought motivated by self-interest.

BOUNDED RATIONALITY n

The hypothesis that people are nearly, but not fully, rational, so that they cannot examine every possible choice available to them but instead use simple rules of thumb to sort among the alternatives that happen to occur to them.

A key behavioral implication of the **bounded rationality** assumption is that people should use so-called rules of thumb.

CETERIS PARIBUS n

The assumption that nothing changes except the factor or factors being studied.

Most models use the **ceteris paribus** assumption that all other things are held constant, or equal.

ECONOMICS **n**

A social science that studies the allocation of limited resources to the production of goods and services used to satisfy consumer's unlimited wants and needs.

Five notable phrases contained in **economics** definition that need further study are: (1) social science, (2) allocation, (3) limited resources, (4) production, and (5) unlimited wants and needs.

ECONOMY **n**

The system of production, distribution, and consumption of goods and services that a society uses to address the problem of scarcity.

The essential task of an **economy** is to transform resources into useful goods and services (the act of production), then distribute or allocate these products to useful ends (the act of consumption).

EVALUATE **v**

If you evaluate something, you decide how valuable it is after considering all its features.

He was asked to **evaluate** the situation.

GOODS **n**

All things from which individuals

derive satisfaction or happiness.

You will frequently see the plural combination of these two phrases together "**goods** and services" to indicate the wide assortment of economic **goods** produced using the economy's scarce resources.

LIMITED **adj**

Something that is limited is rather small in amount or degree.

Economics is the study of how people allocate their **limited** resources in an attempt to satisfy their unlimited wants.

MACROECONOMICS **n**

The branch of economics that studies the entire economy, especially such topics as aggregate production, unemployment, inflation, and business cycles.

Macroeconomics can be thought of as the study of the economic forest, as compared to microeconomics, which is study of the economic trees.

MICROECONOMICS **n**

The branch of economics that studies the parts of the economy, especially such topics as markets, prices, industries, demand, and supply.

Microeconomics can be thought of as the study of the economic trees, as compared to macroeconomics, which is study of the entire economic forest.

MODELS, OR THEORIES **n**

Simplified representations of the real world used as the basis for predictions or explanations.

Social scientists, and especially economists, usually have to test their **models, or theories**, by examining what has already happened in the real world.

NATURE **n**

The nature of something is its basic quality or character.

"An Inquiry into the **Nature** and Causes of the Wealth of Nations" is the Adam Smith's most famous book.

NORMATIVE ECONOMICS **n**

Analysis involving value judgments about economic policies; relates to whether things are good or bad. A statement of *what ought to be*.

When the values are interjected into the analysis, we enter the realm of **normative economics**.

POSITIVE ECONOMCS **n**

Analysis that is strictly limited to making either purely descriptive statements or scientific predictions; for example, "If A, then B". A statement of *what is*.

A **positive economic** statement is “If the price of gasoline rises, people will buy less.”

PREDICTION **n**

If you make a prediction, you say what you think will happen.

Proponents of behavioral economics have not conclusively demonstrated that paying closer attention to psychological thought processes can improve economic **predictions**.

PRODUCTION **n**

The process of transforming the inputs into the outputs.

Economics is a social science that studies the allocation of limited resources to the **production** of goods and services used to satisfy consumer's unlimited wants and needs.

PURCHASE **n**

The act of buying something.

He sold the house he had **purchased** only two years before.

RATIONALITY **n**

The assumption that people do not intentionally make decisions that would leave them worse off.

The bulk of economic analysis continues to rely on the **rationality** assumption as the basis for constructing economic models.

SATISFACTION **n**

The process of successfully fulfilling wants and needs. A basic fact of life is that people want and need stuff to stay alive and to make that life more enjoyable.

Satisfaction is the economic term that captures wants-and-needs-fulfilling process.

SERVICES **n**

Activities that provide direct satisfaction of wants and needs without the production of tangible products or goods. Examples include information, entertainment, and education.

Term **service** should be contrasted with the term good, which involves the satisfaction of wants and needs with tangible items.

Vocabulary

Exercise 1.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	**Column B**
1. allocate	a. buy
2. limited	b. cost
3. satisfy	c. standard
4. produce	d. output
5. purchase	e. apportion
6. prediction	f. restricted
7. normative	g. character
8. nature	h. fulfill
	i. forecasting
	j. manufacture

Defining Economics

Economics is part of the social sciences and as such seeks explanations of real events. All social sciences analyze human behavior, as opposed to the physical sciences, which generally analyze the behavior of electrons, atoms, and other nonhuman phenomena. Economics is the study of how people allocate their limited resources in an attempt to satisfy their unlimited wants. As such, economics is the study of how people make choices.

To understand this definition fully, two other words need explaining: *resources* and *wants*. Resources are things that have value and, more specially, are used to produce goods and services that satisfy people's wants. Wants are all of the items that people would purchase if they had unlimited income.

Whenever an individual, a business, or a nation forces alternatives, a choice must be made, and economics helps us study how those choices are made. For example, you have to choose how to spend your limited income. You also have to choose how to spend your limited time. You may have to choose how much of your company's limited funds to spend on advertising and how much to spend on new-product research. In economics, we examine situations in which individuals choose how to do things, when to do things, and with whom to do them. Ultimately, the purpose of economics is to explain choices.

• Microeconomics versus Macroeconomics

Economics is typically divided into two types of analysis: *microeconomics* and *macroeconomics*.

Macroeconomics is the part of economic analysis that studies decision making undertaken by individuals (or households) and by firms. It is like looking through a microscope to focus on the small parts of our economy. Macroeconomics is the part of economic analysis that studies the behavior of the economy as a whole. It deals with economywide phenomena such as changes in unemployment, in the general price level, and in national income. Microeconomic analysis, for example, is concerned with the effects of changes in the price of gasoline relative to that of other energy sources. It examines the effects of new taxes on a specific product or industry. If price controls were reinstituted in Iran, how individual firms and consumers would react (in the realm of microeconomics)? The effects of higher wages brought about by an effective union strike would also be analyzed using the tools of microeconomics. In contrast, issues such as the rate of inflation, the amount of economywide unemployment, and the yearly growth in the output of goods and services in the nation all fall into the realm of macroeconomics analysis. In other words, macroeconomics deals with aggregates, or totals-such as total output in an economy.

Be aware, however, of the blending of microeconomics and macroeconomics in modern economic theory. Modern economists are increasingly using microeconomics analysis-the study of decision making by individuals and by firms-as the basis of macroeconomics analysis. They do this because even though macroeconomics analysis focuses on aggregates, those aggregates are the result of choices made by individuals and firms.

• The Economic Person: Rational Self-Interest

Economics assume that individuals act as motivated by self-interest and respond predictably to opportunities for gain. This central insight of economics was first clearly articulated by Adam Smith in 1776. Smith wrote in his most famous book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, that “it is not from the benevolence of the butcher, the brewer, or the banker that we expect our dinner, but from their regard to their own interest”. Thus, the typical person about whom economists make behavioral predictions is assumed to act *as thought* motivated by self-interest. Because monetary benefits and costs of actions are often the most easily measured, economists make behavioral predictions about individuals' responses to opportunities to increase their wealth, measured money terms.

The rationally assumption of economics, simply stated, is as follows: We assume that individuals do not intentionally make decisions that would leave them worse off.

• Economics as a Science

Economics is a social science that employs the same kinds of methods used in other sciences, such as biology, physics, and chemistry. Like these other sciences, economics uses models, or theories. Economics models, or theories, are simplified representations of the real world that we use to help us understand, explain, and predict economic phenomena in the real world. There are, of course, differences between sciences. The social sciences-especially economics-make little use of laboratory experiments in which changes in variables are studied under controlled conditions. Rather, social scientists, and especially economists, usually have to test their models, or theories, by examining what has already happened in the real world.

• Positive versus Normative Economics

Economics uses *positive analysis*, a value-free approach to inquiry. No subjective or moral judgments enter into the analysis. Positive analysis relates to statements such as "If A, then B". For example, "If the price of gasoline goes up relative to all other prices, then the amount of it that people buy will fall". That is a positive economic statement. It is a statement of *what is*. It is not a statement of anyone's value judgment or subjective feelings. When our values are interjected into the analysis, we enter the realm of *normative economics*, involving normative analysis. A positive economic statement is "If the price of gasoline rises, people will buy less". If we add to that analysis the statement "so we should not allow the price to go up", we have entered the realm of normative economics-we have expressed a value judgment.

Vocabulary and Comprehension Exercise

Exercise 1.2

Fill in the blanks with appropriate words from the following list.

theory	normative	model	bounded rationality
rationality	wants	self-interest	microeconomics
positive	unlimited	macroeconomics	ceteris paribus
behavioral			

1. Economics is a social science that involves the study of how individuals choose among alternatives to satisfy their…………, which are what people would buy if their incomes were ……..

2. In account of text, ……….., the study of the decision-making process of individuals (or households) and firms, and ……….., the study of the performance of the economy as a whole, are the two main branches into which the study of economics is divided.

3. In economics, we assume that people do not intentionally make decisions that will leave them worse off. This is known as the ………… assumption.

4. In account of text, ……….. is not confined to material well-being but also involves any action that makes a person feel better off, such as having more friends, power, or affection or providing more help to others.

5. A ……., or ………., uses assumptions and is by nature a simplification of the real world. The usefulness of a model can be evaluated by bringing empirical evidence to bear on its predictions.

6. Most models use the ………. assumption that all other things are held constant, or equal.

7. In account of text, ……….. economics emphasizes psychological constraints and complexities that potentially interfere with rational decision making. This approach utilizes the ………. hypothesis that people are not quiet rational, because they cannot study every possible alternative but instead use simple rules of thumb to decide among choices.

8. In account of text, ………. economics is value-free and relates to statements that can be refused, such as “If A, then B”.

9. In account of text, ………… economics involves people’s value and typically uses the word *should*.

Comprehension Exercises

Exercise 1.3

First read the text carefully and then choose the best choice to complete each question.

1. Which one is not belong to social sciences?

a. economics
b. biology
c. accounting
d. management

2. Which one belongs to macroeconomics?

a. trade
b. price
c. production
d. inflation

3. According to the passage, which one of the following issues is not the subject matter of economics?

a. consumption
b. production
c. exchange
d. political election

4. In account of text, …….. simplifies representations of the real world that we use to help us understand economic phenomena in the real world.

a. microeconomics
b. theories
c. models
d. b and c

5. Modern economists are increasingly using ……….. as the basis of macroeconomic analysis.

a. Rationality assumption
b. models
c. Microeconomics analysis
d. theories

Exercise 1.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …… Economics is the study of how people make choices.
2. ……. Needs are things that have value and, more specially, are used to produce goods and services that satisfy people’s wants.
3. ……. Microeconomics examines the effects of new taxes on a specific product or industry.
4. …….. Economics is a social science that employs the same kinds of methods used in other sciences.
5. …….. Normative analysis relates to statements such as “If A, then B”.
6. ……... Macroeconomics is like looking through a microscope to focus on the small parts of our economy.

Exercise 1.5

After reading the text, try to provide full answers to the following questions.

1. What is the purpose of economics?
2. What is the difference between microeconomics and macroeconomics?

3. Categorize each of the following issues either a microeconomic issue, a macroeconomic issue, or not an economic issue.
   a. The national unemployment rate
   b. The decision of a work overtime or not
   c. A family's choice to have a baby
   d. The rate of growth of the money supply
   e. The national government's budget deficit
   f. A student's allocation of study time between two subjects
4. Categorize each of the following conclusions as being the result of positive analysis or normative analysis.
   a. A higher minimum wage will reduce employment opportunities for minimum wage workers.
   b. Increase the earnings of minimum wage employees is desirable, and raising the minimum wage is the best way to accomplish this.
   c. Everyone should enjoy open access to health care.
   d. Health care subsidies will increase the consumption of health care.
5. Suppose that one of your classmates is a hardworking student, serious about his classes, and conscientious about his grades. He is also involved, however, in volunteer activities and an extracurricular sport. Is he displaying rational behavior? Based on what you read in this chapter, construct an argument supporting the conclusion that he is.

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Behavioral Economics and Bounded Rationality

In recent years, some economists have proposed paying more attention to psychologists and psychiatrists. They have suggested an alternative approach to economic analysis. Their approach, which is known as *behavioral economics*, examines consumer behavior in the face of psychological limitations and complications that may interfere with rational decision making.

- **Bounded Rationality**

Proponents of behavioral economics suggest that traditional economic models assume that people exhibit three "unrealistic" characteristics:

1. Unbounded selfishness. People are interested only in their own satisfaction.
2. Unbounded willpower. Their choices are always consistent with their long-term goals.
3. Unbounded rationality. They are able to consider every relevant choice.

Instead, advocates of behavioral economics have proposed replacing the rationality assumption with the assumption of bounded rationality, which assumes that people cannot examine and think through every possible choice they confront. As a consequence, behavioral economics suggest, people cannot always pursue their long-term personal interests. From time to time, they must also rely on other people and take into account other people's interests as well as their own.

- **Rules of Thumb**

A key behavioral implication of the bounded rationality assumption is that people should use so-called *rules of thumb*: Because every possible choice cannot be considered; an individual will tend to fall back on methods of making decisions that are simple than trying to sort through every possibility.

A problem confronting advocates of behavioral economics is that people who appear to use rules of thumb may in fact behave as if they are fully rational. For instance, if a person faces persistently predictable ranges of choices for a time, the individual may rationally settle into repetitive behaviors that an outside observer might conclude to be consistent with a rule of thumb. The bounded rationality assumption indicates that the person should continue to rely on a rule of thumb even if there is a major change in the environment that the individual faces. Time and time again, however, economists find that people respond to altered circumstances by fundamentally changing their behaviors. Economists also generally observe that people make decisions that are consistent with their own self-interest and long-term objectives.

- **Behavioral Economics: A Work in Progress**

It remains to be seen whether the application of the assumption of bounded rationality proposed by behavioral economists will truly alter the manner in which economists construct models intended to better predict human decision making. So far, proponents of behavioral economics have not conclusively demonstrated that paying closer attention to psychological thought processes can improve economic predictions.

As a consequence, the bulk of economic analysis continues to rely on the rationality assumption as the basis for constructing economic models. Advocates of behavioral economics continue to explore ways in which psychological elements might improve analysis of decision making by individual consumers.

Keywords

Assumption	فرض	Limit	محدود
Ceteris paribus	ثابت بودن سایر شرایط	Macroeconomics	اقتصاد کلان
Economics	علم اقتصاد	Microeconomics	اقتصاد خرد
Evaluate	ارزیابی کردن	Nature	ماهیت
Firm	بنگاه	Prediction	پیش‌بینی
Fulfill	تامین کردن	Price	قیمت
Fund	ذخیره مالی	Purchase	خریداری کردن
Household	خانوار	Rational	عقلائی
Industry	صنعت	Spend	خرج کردن
Inflation	تورم	Unemployment	بیکاری

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 1.1

1. e	2. f	3. h	4. j
5. a	6. i	7. c	8. g

Exercise 1.2

1. wants, unlimited	2. microeconomics, macroeconomics	
3. rationality	4. self-interest	5. model, theory
6. ceteris paribus	7. behavioral, bounded rationality	
8. positive	9. normative	

Exercise 1-3

1. b	2. d	3. d	4. d
5. c			

Exercise 1-4

1. T	2. F	3. T	4. T
5. F	6. F		

Exercise 1-5

1. In economics, we examine situations in which individuals choose how to do things, when to do things, and with whom to do them. Ultimately, the purpose of economics is to explain choices.

2. Microeconomics can be thought of as the study of the economic trees, as compared to macroeconomics, which is study of the entire economic forest.

3.

a. a macroeconomics issue	b. a microeconomics issue
c. not an economic issue	d. a macroeconomics issue
e. a macroeconomics issue	f. a microeconomics issue

4.

a. Positive
b. Normative
c. Normative
d. Positive

5. He is displaying rational behavior if all of these activities are in his self-interest. For example, he likely derives intrinsic benefit from volunteer and extracurricular activities and may believe that these activities, along with good grades, improve his prospects of finding a job after he completes his studies. Hence, these activities are in his self-interest even though they reduce some available study time.

Chapter 2

Scarcity and the World of Trade-Offs

General Objectives

This unit has been designed to help you to:

- Evaluate whether even affluent people face the problem of scarcity.
- Understand why economics considers individual's "wants" but not their "needs".
- Explain why the scarcity problem induces individuals to consider opportunity costs.
- Discuss why obtaining increasing increments of any particular good typically entails giving up more units of other goods.
- Distinguish between absolute and comparative advantage.

Behavioural Objectives

After reading the text, students are expected to:

- Define the meaning of words presented at the beginning of this chapter, and Exercises 2.1 and 2.2.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises 2.3, 2.4 and 2.5.

Vocabulary Help

ALTERNATIVE **n**

One thing that can exist or that you can do instead of another.

Scarcity requires us to choose. Whenever we choose, we lose the next-highest valuated **alternative**.

CAPITAL **n**

One of the four basic categories of resources, or factors of production. It includes the manufactured (or previously produced) resources used to manufacture or produce other things.

Common examples of **capital** are the factories, buildings, trucks, tools, machinery, and equipment used by businesses in their productive pursuits.

CONSUMPTION **n**

The use of resources, goods, or services to satisfy wants and needs.

At the microeconomic level, **consumption** is primarily analyzed in the context of utility, demand and their importance to market exchanges.

DESIRE **n**

A desire is a wish to do or have something.

Whenever a choice is made to produce or buy something, something else that is also **desired** is not produced or not purchased.

ECONOMIC GROWTH **n**

Increases in per capita real GDP measured by its rate of change per year.

Economic growth occurs because of many things, including increase in the number of workers and productive investment in equipment.

PRODUCTION POSSIBILITIES CURVE n

A curve representing all possible combinations of maximum outputs that could be produced assuming a fixed amount of productive resources of a given quality.

At any particular point in time, a society cannot be outside the **production possibilities curve**.

ENTREPRENEURSHIP n

One of the four basic categories of resources, or factors of production (the other three are labor, capital, and land).

Entrepreneurship is a special sort of human effort that takes on the risk of bringing labor, capital, and land together and organizing production.

FORGONE n

If you forgone something, you give it up or do not insist on having it.

The highest valued alternative will **forgo** in the pursuit of an activity.

HUMAN CAPITAL n

The sum total of a person's productive knowledge, experience, and training. The acquisition of human capital is what makes a person more productive.

One of the most notable methods of stocking up on **human capital** is through formal education-from grade school to advanced college degrees.

INCOME **n**

Revenue earned or received by households that can be used for consumption or saving.

For the aggregate economy, earned **income** is termed national income, while received **income** is termed personal income.

INDIVIDUAL **n**

Relating to one person or thing, rather than to a large group.

Some **individuals** can accurately solve mathematical problems at lower cost than others who might try to solve the same problems.

LABOR **n**

One of the four basic categories of resources, or factors of production (the other three are capital, land, and entrepreneurship).

Labor is the services and efforts of humans that are used for production.

LAND **n**

One of four basic categories of resources, or factors of production (the other three are labor, capital, and entrepreneurship).

Land includes the natural resources used to produce goods and services, including the land itself; the minerals and nutrients in the ground; the water, wildlife, and vegetation on the surface; and the air above.

NEEDS **n**

This is often thought of as a physiological or biological requirement for maintaining life, such as the need for air, water, food, shelter, and sleep. Satisfaction is achieved by fulfilling needs.

Physiological **needs** should be contrasted with psychological wants that make life more enjoyable but are not necessary to stay alive.

OPPORTUNITY COST **n**

The highest-valued next-best alternative that must be sacrificed to obtain something or to satisfy a want.

The ultimate source of **opportunity cost** is the pervasive problem of scarcity (unlimited wants and needs, but limited resources).

SCARCITY **n**

A pervasive condition of human existence that exists because society has unlimited wants and needs, but limited resources used for their satisfaction.

We live in a big, bad world of scarcity. This big, bad world of **scarcity** is what the study of economics is all about. That's why we usually subtitle **scarcity**: The Economic Problem.

TRADE-OFF **n**

Replacing one thing with another.

When you think of any alternative, you are thinking of **trade-offs**.

WANTS	**n** This is often thought of as a psychological desire which makes life just a little more enjoyable, but which is not physiological necessary to life. You need oxygen, but you want a hot fudge sundae.

Satisfaction is achieved by fulfilling **wants**.

Vocabulary

Exercises 2.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. scarcity	a. give up
2. individual	b. wish for
3. desire	c. revenue
4. income	d. quality of being full of initiative
5. consumption	e. occasion
6. labor	f. of a particular person
7. entrepreneurship	g. option
8. opportunity	h. work-force
9. forgo	i. using up
10. alternative	j. state of being in short supply
	k. money
	l. cost

Scarcity and the World of Trade-Offs

Whenever individuals or communities cannot obtain everything they desire simultaneously, they must make choices. Choices occur because of *scarcity*. Scarcity is the most basic concept in all of economies. Scarcity means that we do not ever have enough of everything, including time, to satisfy our every desire. Scarcity exists because human wants always exceed what can be produced with the limited resources and time that nature makes available.

- **What Scarcity is Not**

Scarcity is not a shortage. After hurricane hits and cuts off supplies to a community, TV newscasts often show people standing in line to get minimum amount of food. A news commentator might say that the line is caused by the “scarcity” of this product. But food is always scarce-we cannot obtain all that we want at a zero price. Therefore, do not confuse the concept of scarcity, which is general and all-encompassing, with the concept of shortages as evidenced by people waiting in line to obtain a particular product.

Scarcity is not the same thing as poverty. Scarcity occurs among the poor and among the rich. Even the richest person on earth faces scarcity. For instance, even the world’s richest person has only limited time available. Low income levels do not create more scarcity. High income levels do not create less scarcity. Scarcity is a fact of life, like gravity. And just as physicists did not invent gravity, economists did not invent scarcity-it existed well before the first economist ever lived. It has existed at all times in the past and will exist at all times in the future.

- **Scarcity and Resources**

Scarcity exists because resources are insufficient to satisfy our every desire. Resources are the inputs used in the production of the things that we want. Production can be defined as virtually any activity that results in the conversion of resources into products that can be used in consumption. Production includes delivering things from one part of the country to another. It includes taking ice from an ice tray to put it in your soft-drink glass. The resources used in production are called factors of production interchangeably. The total quantity of all resources that an economy has at any time determines what that economy can produce.

Factors of production can be classified in many ways. Here is one such classification:

1. **Land**. Land encompasses all the nonhuman gifts of nature, including timber, water, fish, materials, and the original fertility of land. It is often called the *natural resources*.
2. **Labor**. Labor is the *human resource*, which includes productive contributions made by individuals who work, such as web page designers and professional football players.
3. **Physical capital**. Physical capital consists of the factories and equipment used in production. It also includes improvements to natural resources, such as irrigation ditches.
4. **Human capital**. Human capital is economic characterization of the education and training of workers. How much the nation produces depends not only on how many hours people work but also on how productive they are, and that in turn depends in part on education and training. To become more educated, individuals have to devote time and resources, just as a business has to devote resources if it wants to increase its physical capital. Whenever a worker's skills increase, human capital has been improved.
5. **Entrepreneurship**. Entrepreneurship (actually a subdivision of labor) is the component of human resources that performs the functions of organizing, managing, and assembling the other factors of production to create and operate business ventures. Entrepreneurship also encompasses taking risks that involve the possibility of losing large sums of wealth on new ventures. It includes new methods of doing common things and generally

experimenting with any type of new thinking that could lead to making more income. Without entrepreneurship, virtually no business organization could operate.

- **Wants and Needs**

Wants are not the same as needs. Indeed, from the economist's point of view, the term *needs* is objectively indefinable. When someone says, "I need some new clothes", there is no way to know whether that person is stating a vague wish, a want, or a lifesaving requirement. If the individual making the statement were dying of exposure in a northern country during the winter, we might argue that indeed the person does need clothes-perhaps not new ones, but at least some articles of warm clothing. Typically, however, the term *need* is used very casually in conversation. What people mean, usually, is that they desire something that they do not currently have.

Humans have unlimited wants. Just imagine that every single material want that you might have, was satisfied. You could have all of the clothes, cars, houses, DVDs, and other items that you want. Does that mean that nothing else could add to your total level of happiness? Undoubtedly, you might continue to think of new goods and services that you could obtain, particularly as they came to market. You would also still be lacking in fulfilling all of your wants for compassion, friendship, affection, prestige, sports abilities, and so on. In reality, every individual has competing wants but cannot satisfy all of them, given limited resources. This is the reality of scarcity. Each person must therefore make choices. Whenever a choice is made to produce or buy something, something else that is also desired is not produced or not purchased. In other words, in a world of scarcity, every want that ends up being satisfied causes one or more other wants to remain unsatisfied or to be forfeited.

- **Scarcity, Choice, and Opportunity Cost**

The natural fact of scarcity implies that we must make choices. One of the most important results of this fact is that every choice made means that some opportunity must be sacrificed. Every choice involves giving up an opportunity to produce or consume something else.

Valuing Forgone Alternatives

Consider a practical example. Every choice you make to study economics for one more hour requires that you give up the opportunity to engage in any of the following activities: study more of another subject, sleep, browse at a local store, read a novel, or work out at the gym. The most highly valued of these opportunities is forgone if you choose to study economics an additional hour. Because there were so many alternatives from which to choose, how could you determine that value of what you gave up to engage in that extra hour or studying economics? First of all, no one else can tell you the answer because only you can put a value on the alternatives forgone. Only you know the value of another hour of sleep-whatever one activity you would have chosen if you had no opted to study economics for that hour. That means that only you can determine the highest-valued, next-best alternative that you had to sacrifice in order to study economics one more hour. Only you can determine the value of the next-best alternative.

Opportunity Cost

The value of the next-best alternative is called opportunity cost. The opportunity cost of any action is the value of what is given up-the next-highest-ranked alternative-because a choice was made. When you study one more hour, there may be many alternatives available for the use of that hour, but assume that you can do only one other thing in that hour-your next-highest-ranked alternative. What is important is the choice that you would have made if you hadn't studied one more hour. Your opportunity cost is the *next-highest-ranked* alternative, not *all* alternatives.

The World of Trade-Offs

Whenever you engage in any activity using any resource, even time, you are *trading off* the use of that resource for one or more alternative uses. The extent of the trade-off is represented by the opportunity cost. The opportunity cost of studying economics has already been mentioned-it is the value of the next-best alternative. When you think of any alternative, you are thinking of trade-offs. Let's consider a hypothetical example of a trade-off between the results of spending time studying economics and mathematics. For the sake of this argument, we will assume that additional time studying either economics or mathematics will lead to a higher grade in the subject to which additional study time is allocated.

Graphical Analysis

In Figure 2-1, the expected grade in mathematics is measured on the vertical axis of the graph, and the expected grade in economics is measured on the horizontal axis. We simplify the world and assume that you have a maximum of 12 hours per week to spend studying these two subjects and that if you spend 12 hours on economics, you will get an A in the course. You will, however, fail mathematics. Conversely, if you spend all of your 12 hours studying mathematics, you will get A in that subject, but you will flunk economics. Here the trade-off is a special case: one to one. A one-to-one trade-off means that the opportunity cost of receiving one grade higher in economics (for example, improving from a C to a B) is one grade lower in mathematics (failing from a C to a D).

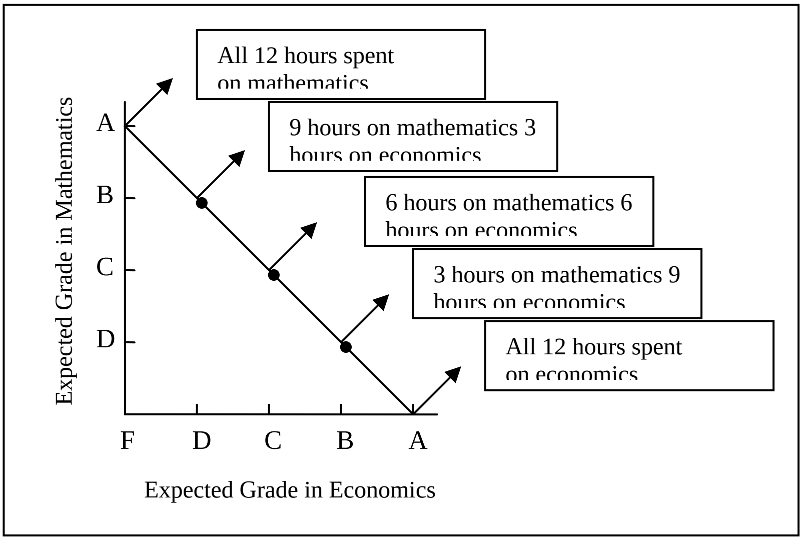

Figure 2-1. Production Possibilities Curve for Grades in Mathematics and Economics (Trade-Offs)

• Economic Growth and the Production Possibilities Curve

At any particular point in time, a society cannot be outside the production possibilities curve. *Over time*, however, it is possible to have more of everything. This occurs through economic growth. (An important reason for economic growth is capital accumulation.) Figure 2-2 shows the production possibilities curve for computer servers and HDTVs shifting outward. The two additional curves shown represent new choices open to an economy that has experienced economic growth. Such economic growth occurs because of many things, including increase in the number of workers and productive investment in equipment.

Scarcity still exists, however, no matter how much economic growth there is. At any point in time, we will always be on some production possibilities curve; thus, we will always face trade-offs. The more we have of one thing, the less we can have of others. If a nation experiences economic growth, the production possibilities curve between servers and HDTVs will more outward, as shown in

Figure 2-2. This takes time and does not occur automatically. One reason it will occur involves the choice about how much to consume today.

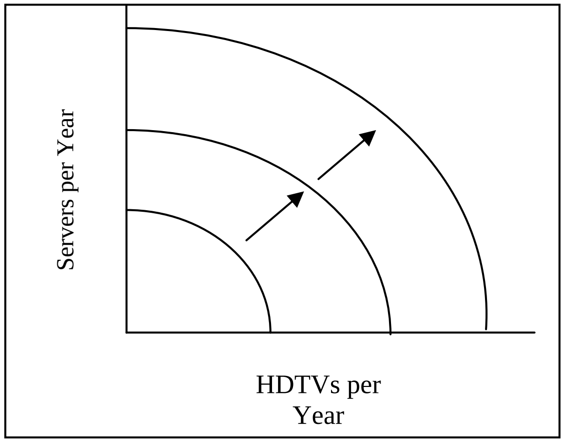

Figure 2-2. Production Possibilities Curve for Computer servers and HDTVs

Vocabulary and Comprehension Exercise

Exercises 2.2

Fill in the blanks with appropriate words from the following list.

labor	next-highest	human	scarcity
entrepreneurship	wants	need	next-best
production possibilities		land	opportunity
physical			

1. In account of text, ……… is the situation in which human wants always exceed what can be produced with the limited resources and time that nature makes available.

2. We use scarce resources, such as …………, …………., …………, and ………. capital, and ………., to produce economic goods-

goods that are desired but are not directly obtainable from nature to the extent demand or desired at a zero price.

3. In account of text, ……….. are unlimited; they include all material desires and all nonmaterial desires, such as affection, power, and prestige.
4. The concept of ……….. is difficult to define objectively for every person; consequently, we simply consider every person's wants to be unlimited. In a world of scarcity, satisfaction of one want necessarily means non-satisfaction of one or more other wants.
5. Scarcity requires us to choose. Whenever we choose, we lose the ………… valuated alternative.
6. Cost is always a forgone …………..
7. Another way to look at opportunity cost is the trade-off that occurs when one activity is undertaken rather than the ……….… alternative activity.
8. A ……… curve graphically shows the trade-off that occurs when more of one output is obtained at the sacrifice of another. This curve is a graphical representation of, among other things, opportunity cost.

Comprehension Exercises

Exercise 2.3

First read the text carefully and then choose the best choice to complete each question.

1. Which one is the most basic concept in all of economics?
   a. entrepreneurship
   b. scarcity
   c. resources
   d. opportunity cost
2. In account of text, ………. is the economic characterization of the education and training of workers.
   a. entrepreneurship

b. scarcity
c. resources
d. opportunity cost

3. From the economist's point of view, the term ………… is objectively indefinable.
a. scarcity
b. wants
c. needs
d. opportunity cost

4. In economics, cost is always a forgone …………
a. scarcity
b. wants
c. needs
d. opportunity

5. The extent of the ………… is represented by the opportunity cost.
a. trade-off
b. wants
c. needs
d. cost

6. If a nation experiences economic growth, the …………… curve will move outward.
a. trade-off
b. production possibility
c. cost
d. none of the above

Exercise 2.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …… Scarcity is a shortage.
2. …… Low income levels do not create more scarcity.

3. ……. Human capital includes improvements to natural resources, such as irrigation ditches.

4. ……. Whenever a choice is made to produce or buy something, something else that is also desired is produced or purchased.

5. ……. Every choice involves giving up an opportunity to produce or consume something else.

6. ……. The opportunity cost of any action is the value of what is given up-the next-highest-ranked alternative-because a choice was made.

Exercise 2.5

After reading the text, try to provide full answers to the following questions.

1. Define scarcity. Why does scarcity exist?
2. How does the economy grow?
3. When does the production possibilities curve will more outward?
4. What is your opportunity cost of attending a class at 11:00 A.M.? How does it differ from your opportunity cost of attending a class at 8:00 A.M.?
5. Based on the information provided in below table, what is the opportunity cost to this student of allocating enough additional study time on economics to move his grade up from 90 to 100?

Economics	Mathematics
100	40
90	50
80	60
70	70
60	80
50	90
40	100

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Comparative and Absolute Advantage

Comparative advantage

Specialization occurs because different individuals experience different costs when they engage in the same activities. Some individuals can accurately solve mathematical problems at lower cost than others who might try to solve the same problems. Thus, those who solve math problems at lower cost sacrifice production of fewer alternative items. Some people can develop more high-quality computer programs than others while giving up less production of other items, such as clean houses and neatly manicured yards.

Comparative advantage is the ability to perform an activity at a lower opportunity cost. You have a comparative advantage in one activity whenever you have a lower opportunity cost of perform that activity. Comparative advantage is always a relative concept. You may be able to change the oil in your car; you might even be able to change it faster than the local mechanic. But if the opportunity cost you face by changing the oil exceeds the mechanic's opportunity cost, the mechanic has a comparative advantage in changing the oil. The mechanic faces a lower opportunity cost for that activity. You may be convinced that everybody can do more of everything than you can during the same period of time and using the same resources. In this extreme situation, do you still have a comparative advantage? The answer is yes. You do not have to be a mathematical genius to figure this out. The market tells you so very clearly by offering you the highest income for the job for which you have a comparative advantage. Stated differently, to find your comparative advantage, simply find the job that maximizes your income.

Absolute advantage

Suppose that, conversely, you have a job at a firm and are convinced that you have the ability to do every job in that company at a lower cost than everyone else who works there. You might be able to keyboard documents into a computer faster than any of the other employees, file documents in order in a file cabinet faster than any of the file clerks, and wash windows faster than any of the window washers. Indeed, you might even be able to manage the firm in less time just as effectively as the current company president-and in less time than you would have to spend in any alternative function. If all of these self-perceptions were really true, then you would have an *absolute advantage* in all of these endeavors. In other words, if you were to spend a given amount of time in any of them, you could produce more than anyone else in the company. Nonetheless, you would not spend your time doing these other activities. Why not? Because your advantage in undertaking the president's managerial duties is even greater. Therefore, you would find yourself specializing in the particular task even though you have an absolute advantage in all these other tasks. Indeed, absolute advantage is irrelevant in predicting how you will allocate your time. Only comparative advantage matters in determining how you will allocate your time.

Keywords

Absolute	مطلق	Forfeit	از دست رفتن
Advantage	مزیت	Forgone	صرف‌نظر کردن
Affluent	ثروتمند	Income	درآمد
Allocate	تخصیص دادن	Investment	سرمایه‌گذاری
Alternative	گزینه	Opportunity cost	هزینه فرصت
Capital	سرمایه	Production	تولید
Comparative	نسبی	Satisfy	راضی کردن
Consumption	مصرف	Scarcity	کمیابی
Desire	میل، آرزو	Trade-off	معاوضه
Entrepreneurship	کارآفرینی	Want	خواسته

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 2-1

1. j	2. f	3. b	4. c
5. i	6. h	7. d	8. e
9. a	10.g		

Exercise 2-2

1. scarcity	2. land, labor, physical, human, entrepreneurship	
3. wants	4. need	5. next-highest
6. opportunity	7. next-best	8.production possibilities

Exercise 2-3

1. b	2. a	3. c	4. d
5. a	6. b		

Exercise 2-4

1. F	2.T	3. F	4. F
5. T	6. T		

Exercise 2-5

1. Scarcity is the most basic concept in all of economics. Scarcity means that we do not ever have enough of everything, including time, to satisfy our every desire. Scarcity exists because human wants always exceed what can be produced with the limited resources and time that nature makes available.

2. At any particular point in time, a society cannot be outside the production possibilities curve. Over time, however, it is possible to have more of everything. This occurs through economic growth. An important reason for economic growth is capital accumulation.

3. If a nation experiences economic growth, the production possibilities curve will more outward.
4. The opportunity cost of attending a class at 11:00 A.M. is the next-best use of that hour of the day. Likewise, the opportunity cost of attending at 8:00 A.M. a class is the next-best use of that particular hour of the day. It you are an early riser, it is arguable that the opportunity cost of the 8:00 A.M. hour is lower, because you will already be up at that time but have fewer choices compared with the 11:00 A.M. hour when whops, recreation centers, and the like are open. If you are a late riser, it may be that the opportunity cost of the 8:00 A.M. hour is higher, because you place a relatively high value on an additional hour of sleep in the morning.
5. If the student allocates additional study time to economics in order to increase his score from 90 to 100, his mathematics score declines from 50 to 40, so the opportunity cost of earning 10 additional points in economics is 10 fewer points in mathematics.

Chapter 3

Demand and Supply

General Objectives

This unit has been designed to help you to:

- Explain the law of demand.
- Distinguish between changes in demand and changes in quantity demanded.
- Explain the law of supply.
- Distinguish between changes in supply and changes in quantity supplied.
- Understand how the interaction of the demand for and supply of a commodity determines the market price of the commodity and the equilibrium quantity of the commodity that is produced and consumed.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the relevant exercises.

Vocabulary Help

COMMODITY **n**

Items that is bought or sold.

The law of demand tells us that the quantity demanded of any **commodity** is inversely related to its price.

COMPLEMENTS **n**

Two goods are complements when a change in price of one causes an opposite shift in the demand for the other.

Computers and printers are **complements** goods.

CONSUMER **n**

A broad term for people when they are engaged in the use of goods and services to satisfy wants and needs.

Consumers are part of the household sector.

CURVE **n**

A line or a graph representing data.

The demand **curve** is simply a graphical representation of the law of demand.

DEMAND **n**

A schedule of showing how much of a good or service people will purchase at any price during a specified time period, other things being constant.

Demand is one half of the market exchange process; the other is supply.

EQUILIBRIUM **n**

A situation in which supply and demand are matched and prices stable.

Any point that is not **equilibrium** is unstable and will not persist.

EXPECTATION **n**

Belief about (or mental picture of) the future.

Expectation of a rise in income may cause consumer to want to purchase more of everything today at today's prices.

FIRM **n**

A business organization that employs resources to produce goods or services for profit. A firm normally owns and operates at least one "plant" or facility in order to produce.

If the number of **firms** increases, supply will increase.

MARKET **n**

All of the arrangements that individuals have for exchanging with one another. Thus, for example, we can speak of the labor market, the automobile market, and the credit market.

Markets are the exchange between buyers who want a good-the demand-side of the market-and sellers who have it-the supply-side of the market.

PRICE **n**

The amount of money needed to purchase something.

When the **price** of a good goes up, people buy less of it.

PREFERENCE **n**

A strong liking.

My own **preference** is for good literature.

QUANTITY **n**

The amount of a good that is bought, sold, or traded among buyers and sellers.

The law of demand states that a change in price causes a change in the **quantity** demanded in the opposite direction.

SCHEDULE **n**

An ordered list of times at which things are planned to occur.

We can construct a supply **schedule**, which is a table relating prices to the quantity supplied at each price.

SHORTAGE **n**

A state or situation in which something needed cannot be obtained in sufficient amounts.

In economics **shortage** is a situation in which quantity demanded is greater than quantity supplied at a price below the market clearing price.

SUBSTITUTES **n**

Two goods are substitutes when a change in the price of one causes a shift in demand for the other in the same direction as the price change.

Butter and margarine are **substitutes** goods.

SUPPLY **n**

A schedule showing the relationship between price and quantity supplied for a specified period of time, other things being constant.

Supply is one half of the market exchange process; the other is demand.

SURPLUS **n**

A quantity much larger than is needed.

In economics **surplus** is a situation in which quantity supplied is greater than quantity demanded at a price above the market clearing price.

Vocabulary

Exercises 3.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. demand	a. make perfect
2. supply	b. anticipation
3. price	c. require
4. schedule	d. give a cost to something
5. quantity	e. buyer
6. preference	f. act of providing
7. substitute	g. option
8. complement	h. alternative
9. expectation	i. amount
10. consumer	j. state of being in short supply
	k. priority
	l. plan for a certain date

Demand and Supply

• Demand

Demand has a special meaning in economics. It refers to the quantities of specific goods or services that individuals, taken singly or as a group, will purchase at various possible prices, other things being constant. We can therefore talk about the demand for microprocessor chips, French fries, multifunction printer-copiers, children, and criminal activities.

The Law of Demand

Associated with the concept of demand is the law of demand, which can be stated as follows:

When the price of a good goes up, people buy less of it, other things being constant. When the price of a good goes down, people buy more of it, other things being constant.

The law of demand tells us that the quantity demanded of any commodity is inversely related to its price, other things being constant. In an inverse relationship, one variable moves up in value when the other moves down. The law of demand states that a change in price causes a change in the quantity demanded in the opposite direction.

Notice that we tacked on to the end of the law of demand the statement “other things being equal”. We referred to this in chapter 1 as the ceteris paribus assumption. It means, for example, that when we predict that people will buy fewer DVD players when their price goes up, we are holding constant the price of all other goods in the economy as well as people’s incomes. Implicitly, therefore, if we are assuming that no other prices change when we examine the price behavior of DVD players, we are looking at the relative price of DVD players.

The Demand Schedule

Let’s take a hypothetical demand situation to see how inverse relationship between the price and the quantity demanded looks (holding other things equal). We will consider the quantity of 256-megabyte secure digital cards (also known as “SD cards”, used in cameras and other digital devices) demanded per year. Without stating the time dimension, we could not make sense out of this demand relationship because the numbers would be different if we were talking about the quantity demanded per month or the quantity demanded per decade.

In addition to implicitly or explicitly stating a time dimension for a demand relationship, we are also implicitly referring to constant quality units of the good or service in question. Prices are always expressed in constant quality units in order to avoid the problem of comparing commodities that are in fact not truly comparable.

In panel (a) of Figure 3-1, we see that if the price is 10000 Rials apiece, 50 secure digital (SD) cards will be bought each year by our representative individual, but if the price is 50000 Rials apiece, only 10 SD cards will be bought each year. This reflects the law of demand. Panel (a) is also called simply demand, or a demand schedule, because it gives a schedule of alternative quantities demanded per year at different possible prices.

Panel (a)

Combination	Price per Constant Quality SD (10000Rials)	Quantity of Constant Quality SD per Year
A	5	10
B	4	20
C	3	30
D	2	40
E	1	50

Panel (b)

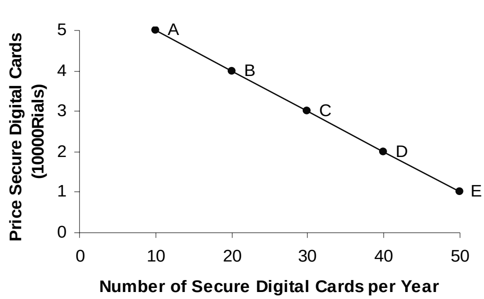

Figure 3-1. The Individual Demand Schedule and the Individual Demand Curve

The Demand Curve

Tables expressing relationships between two variables can be represented in graphical terms. To do this, we need only construct a graph that has the price per constant-quantity secure digital card on the vertical axis and the quantity measured in constant-quantity SD cards per year in the horizontal axis. All we have to do is take combinations A through E from panel (a) of Figure 3-1 and plot those points in panel (b). Now we connect the points with a smooth line, and voila, we have a demand curve. It is downward sloping (from left to right) to indicate the inverse relationship between the price of SD cards and the quantity demanded per year. Our presentation of demand schedules and curves applies equally well to all commodities, including dental floss, bagels, textbooks, credit, and labor. Remember, the demand curve is simply a graphical representation of the law of demand.

Shifts in Demand

- **Income**; for most goods, an increase in income will lead to an increase in demand. That is, an increase in income will lead to a rightward shift in the position of the demand curve from, say, D_1 to D_2 in Figure 3-2.
- **Tastes and Preferences;** a change in consumer tastes in favor of a good can shift its demand curve outward to the right. That is, an increase in income will lead to a rightward shift in the position of the demand curve from, say, D_1 to D_2 in figure 3-2.
- **Price of Substitutes and Complements Goods;** demand schedules are always drawn with the prices of all other commodities held constant. That is to say, when driving a given demand curve, we assume that only price of the good under study changes. When we refer to related goods, we are talking about goods for which demand is interdependent. If a change in the price of one good shifts the demand for another good, those two goods have interdependent

demands. There are two types of demand interdependencies: those in which goods are *substitutes* and those in which goods are *complements*. We can define and distinguish between substitutes and complements in terms of how the change in price of one commodity affect the demand for its related commodity. Butter and margarine are substitutes. Either can be consumed to satisfy the same basic want. If the price of butter remains the same and the price of margarine falls, people will buy more margarine and less butter. The demand curve for butter shifts inward to the left. In other words, a decrease in price of margarine will lead to a decrease in the demand for butter. For complements, goods typically consumed together, the situation is reversed. Consider desktop computers and printers. We draw the demand for printers with the price of desktop computers held constant. If the price per constant-quantity unit of computers decreases, that will encourage more people to purchase computer peripheral devices. They will now buy more printers, at any given printer price, than before. The demand curve for printers will shift outward to the right. To summarize, a decrease in price of computers leads to an increase in the demand for printers.

- **Expectations;** consumers' expectations regarding future prices and future incomes will prompt them to buy more or less of a particular good without a change in its current money price. For example, consumer getting wind of a scheduled 100 percent increase in the price of secure digital cards next month will buy more of them today at today's prices. Today's demand curve for SD cards will shift outward to the right. Expectation of a rise in income may cause consumer to want to purchase more of everything today at today's prices. Again, such a change in expectations of higher future income will cause a shift in the demand curve outward to the right. Finally, expectations that goods will not be available at any price will induce consumers to stock up now, increasing current demand.

- **Market Size (Number of Potential Buyers);** an increase in the number of potential buyers (holding buyers' income constant) at any given price shifts the market demand curve outward. Conversely, a reduction in the number of potential buyers at any given price shifts the market demand curve inward.

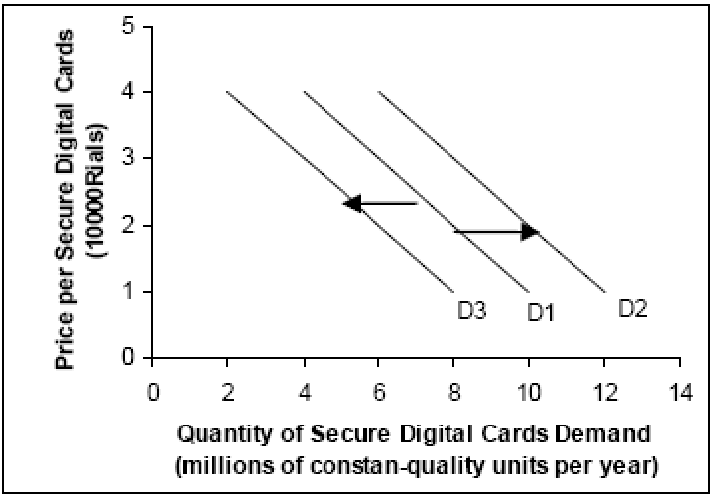

Figure 3-2. A Shift in the Demand Curve

- **Supply**

A schedule showing the relationship between price and quantity supplied for a specified period of time, other things being constant.

- **The Law of Supply**

The other side of the basic model in economics involves the quantities of goods and services that firms will offer for sale to the market. The supply of any good or service is the amount that firms will produce and offer for sale under certain conditions during a specified time period. The relationship between price and quantity supplied, called the law of supply, can be summarized as follows:

At higher prices, a larger quantity will generally be supplied than at lower prices, all other things held constant. At lower prices, a smaller quantity will generally be supplied than at higher prices, all other things held constant.

The Supply Schedule

Just as we were able to construct a demand schedule, we can construct a supply schedule, which is a table relating prices to the quantity supplied at each price. A supply schedule can also be referred to simply as supply. It is a set of planned production rates that depends on the price of the product. We show the individual supply schedule for a hypothetical producer in panel (a) of figure 3-3. At a price of 10000 Rials per secure digital card, for example, this producer will supply 20000 SD cards per year. At a price of 50000 Rials per SD card, this producer will supply 55000 SD cards per year.

The Supply Curve

We can convert the supply schedule from panel (a) of figure 3-3 into a supply curve, just as we earlier created a demand curve in figure 3-1. All we do is take the price-quantity combinations from panel (a) of figure 3-3 and plot them in panel (b). We have labeled these combinations F through J. Connecting these points; we obtain an upward-sloping curve that shows the typically direct relationship between price and quantity supplied. Again, we have to remember that we are talking about quantity supplied per year, measured in constant-quality units.

Panel (a)		
Combination	Price per Constant Quality SD (10000Rials)	Quantity SD Supplied (thousands of constant-quality units per Year
F	5	55
G	4	40
H	3	35
I	2	25
J	1	20

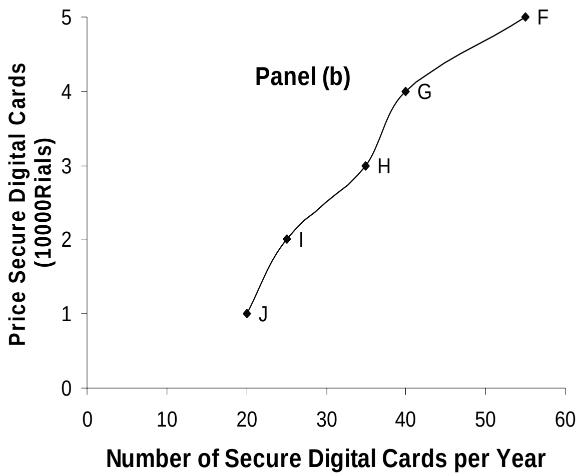

Figure 3-3. The Individual Producer's Supply Schedule and Supply Curve

Vocabulary and Comprehension Exercise

Exercises 3.2

Fill in the blanks with appropriate words from the following list.

tastes	demand	ceteris paribus	direct
inverse	expectations	market demand	taxes and subsidies
movement	constant	shift	greater
along			

1. The law of demand posits a(n) ……… relationship between the quantity demanded of a good and its price, other things being constant.

2. The law of ………. applies when other things, such as income and the prices of all other goods and services, are held constant.

3. We measure the demand schedule in terms of a time dimension and in ………… quality units.

4. The ……………. curve is derived by summing the quantity demanded by individuals at each price.

5. Demand curves are drawn with determinants other than the price of the good held constant. These other determinants, called ceteris paribus conditions, are income; …………; prices of related goods; expectation; and market size at any given price. If any one of these determinants changes, the demand curve will shift to the right or to the left.

6. A change in demand comes about only because of a change in the ………… condition of demand. This change in demand is a shift in the demand curve to the left or to the right.

7. A change in the quantity demanded comes about when there is a change in the price of the good (other things held constant). Such a change in quantity demanded involves …………… a given demand curve.

8. If the price changes, we move along a curve-there is a change in quantity demanded or supplied. If some other determinant changes, we ……….. a curve- there is a change in demand or supply.

9. There is normally a ……….. relationship between price and quantity of a good supplied, other things held constant.

10. The supply curve is drawn with other things held constant. If these ceteris paribus conditions of supply change, the supply curve will shift. The major ceteris paribus conditions are input prices, ………….., technology and productivity, ……….., and the number of firms in the industry.

Comprehension Exercises

Exercise 3.3

1. The law of demand tells us that the quantity demanded of any commodity is ……….. to its price, other things being equal.

a. inversely related

b. directly related

c. independent

d. just dependent

2. An increase in income will lead to a ………… the position of the demand curve.

a. leftward shift in

b. rightward shift in

c. movement along

d. none of the above

3. Which one shifts the demand curve leftward down?

a. an increase in income

b. a change in consumer tastes in favor of considered good

c. a decrease in price of substitute good

d. a decrease in price of complementary good

4. Which one does not shift the demand curve?

a. an increase in income

b. a change in consumer tastes in favor of considered good

c. a decrease in price of considered good

d. a decrease in price of complementary good

5. The law of …….. says: at higher prices, a …….. quantity will generally be …….. than at lower prices, all other things held constant.

a. demand, larger, demanded

b. supply, larger, demanded

c. demand, larger, supplied

d. supply, larger, supplied

Exercise 3.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …….. When the price of a good goes down, people buy less of it, other things being equal.

2. …….. For all goods, an increase in income will lead to an increase in demand.

3. ……... If the price of butter remains the same and the price of margarine falls, people will buy more margarine and butter.

4. ……… If the price pre constant-quantity unit of computers decreases, that will encourage more people to purchase computer peripheral devices.

5. ……… Expectation of a rise in income may cause consumer to want to purchase more of everything today at today's prices.

6. ……… an increase in the number of potential buyers at any given price shifts the market demand curve inward.

Exercise 3.5

After reading the text, try to provide full answers to the following questions.

1. Define the demand and supply laws with a practical example for each of them.

2. Which items do affect on book demand for a university student?

3. Consider the market for DSL high-speed Internet access service, which is a normal good. Explain whether the following events would cause an increase or a decrease in demand or an increase or decrease in the quantity demanded.

a. Firms providing cable Internet access services reduce their prices.

b. Firms providing DSL high-speed Internet access services reduce their prices.

c. There is a decrease in the incomes earned by consumers of DSL high-speed Internet access services.
d. Consumers of DSL high speed Internet access services anticipate a decline in the future prices of these services.

4. Give an example of a complement and a substitute in consumption for each of the following items.
a. Meat
b. Tennis racquets
c. Coffee
d. Automobiles

5. Suppose that in a recent market period, the following relationship existed between the price of prerecorded movie DVDs and the quantity supplied and quantity demanded.

Price (Rials)	Quantity Demanded	Quantity Supplied
190000	100 million	40 million
200000	90 million	60 million
210000	80 million	80 million
220000	70 million	100 million
230000	60 million	120 million

Graph the supply and demand curves for movie DVDs given the information in the table. What are the equilibrium price and quantity? If the industry price is 200000, is there a shortage or surplus of DVDs? How much is the shortage or surplus?

Translation Practice

Translate the following text into fluent Persian.

Shifts in Supply, Equilibrium

- **Cost of Inputs Used to Produce the Product;** if one or more input prices fall, production cost fall, and the supply curve will shift outward to the right; that is, more will be supplied at each and every price.

- **Technology and Productivity;** supply curves are drawn by assuming a given technology. When the available production techniques change, the supply curve will shift. For example, when a better production technique for SD cards become available, production costs decrease and the supply curve will shift to the right.
- **Taxes and Subsidies;** certain taxes, such as a per-unit tax, are effectively an addition to production costs and therefore reduce the supply. If the supply curve is S_1 in Figure 3-4, a per-unit tax increase would shift it to S_3. A per-unit subsidy would do the opposite; it would shift the curve to S_2.
- **Price Expectations;** a change in the expectation of a future relative price of a product can affect a producer's current willingness to supply, just as price expectations affect a consumer's current willingness to purchase. For example, suppliers of SD cards may withhold from the market part of their current supply if they anticipate higher prices in the future. The current amount supplied at each and every price will decrease.
- **Number of Firms in the Industry;** in the short run, when firms can change only the number of employees they use, we hold the number of firms in the industry constant. In the long run, the number of firms may change. If the number of firms increases, supply will increase, and the supply curve will shift outward to the right. If the number of firms decreases, supply will decrease, and the supply curve will shift inward to the left.

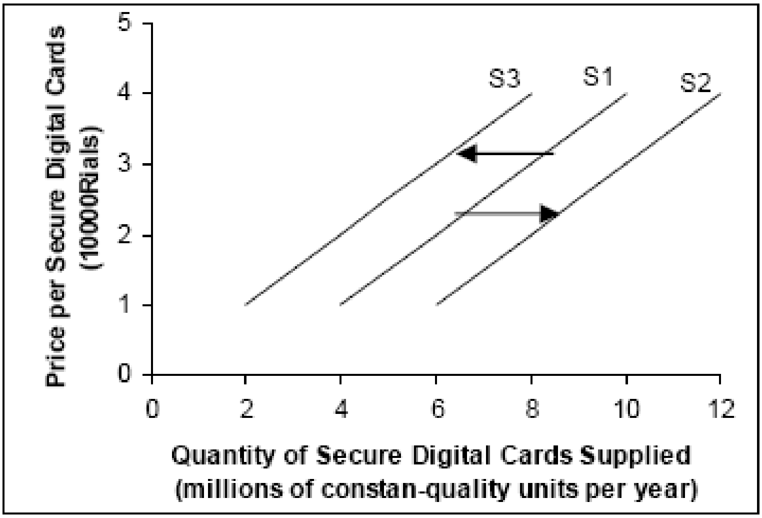

Figure 3-4. A Shift in the Supply Curve

Equilibrium, Shortages and Surpluses

We can define equilibrium in general as a point at which quantity demanded equals quantity supplied at a particular price (See figure 3-5). There trends to be no movement of the price or the quantity away from this point unless demand or supply changes. Any movement away from this point will set into motion forces that will cause movement back to it. Therefore, equilibrium is a stable point. Any point that is not equilibrium is unstable and will not persist.

Shortages and scarcity are not the same thing. A shortage is a situation in which the quantity demanded exceeds the quantity supplied at a price that is somehow kept below the market clearing price (See figure 3-5). Our definition of scarcity was much more general and encompassing: a situation in which the resources available for producing output are insufficient to satisfy all want. Inversely, surplus is a situation which quantity supplied is greater then quantity demanded at a price above market cleaning price (See figure 3-5).

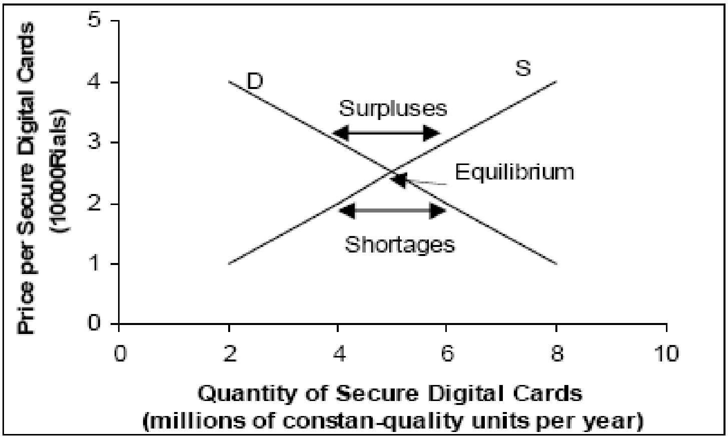

Figure 3-5. Equilibrium, Shortages and Surpluses

Keywords

Anticipation	انتظار، پیش‌بینی	Increase	افزایش
Consumer	مصرف‌کننده	Market	بازار
Commodity	کالا	Preference	رجحان، برتری
Complement	مکمل	Quantity	مقدار
Curve	منحنی	Substitute	جانشین
Decrease	کاهش	Schedule	برنامه زمانی
Demand	تقاضا	Supply	عرضه
Downward	رو به پائین	Surplus	مازاد
Equilibrium	تعادل	Taste	سلیقه
Explicitly	آشکار	Upward	رو به بالا
Implicitly	ضمنی		

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 3-1

1. c	2. f	3. d	4. l
5. i	6. k	7. h	8. a
9. b	10. e		

Exercise 3-2

1. inverse 2.demand 3. constant
4. market demand 5. tastes 6. ceteris paribus
7. movement along 8. shift 9. direct
10. taxes and subsidies, expectations

Exercise 3-3

1. a	2. b	3. c	4. c
5. d			

Exercise 3-4

1. F	2.F	3. F	4. T
5. T	6. F		

Exercise 3-5

1. The law of demand tells us that the quantity demanded of any commodity is inversely related to its price, other things being equal. For example, if the price pre constant-quantity unit of laptop decreases, that will encourage more people to purchase laptop. The law of supply tells us that the quantity supplied of any commodity is directly related to its price, other things being equal. For example, if the price pre constant-quantity unit of laptop increases, that will encourage more producers to produce laptop.

2. The price of book, the university student's income or their pocket money, the university student's tastes and preferences in favor of special bibliography, the price of substitutes and complements books, the university student's expectations and the number of potential students who want to buy book.

3.

a. DSL and cable Internet access services are substitute, so a reduction in the price of cable Internet access services causes a decrease in the demand for DSL high-speed Internet access services.

b. A decrease in the price of DSL Internet access services generates an increase in the quantity of these services demanded.

c. DSL high-speed Internet access services are a normal good, so a fall in the incomes of consumers reduces the demand for these services.

d. If consumers expect that the price of DSL high-speed Internet services will fall in the future, then the demand for these services will tend to decrease today.

4.

a. Complement: eggs; Substitute: sausage

b. Complement: tennis balls; Substitute: racquet-ball racquets

c. Complement: cream; Substitute: tea

d. Complement: gasoline; Substitute: city bus

5. The equilibrium price is 210000 Rials per DVD, and the equilibrium quantity is 80 million DVDs. At a price of 200000 Rials per DVD, the quantity of DVDs demanded is 90 million, and the quantity of DVDs supplied is 60 million. Hence, there is a shortage of 30 million DVDs at a price of 200000 Rials per DVD.

Chapter 4

Public Spending

General Objectives

This unit has been designed to help you to:

- Explain how market failures such as externalities might justify economic functions of government.
- Distinguish between private goods and public goods.
- Explain the nature of the free-rider problem.
- Describe political functions of government that entail its involvement in the economy.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

COMPETITION **n**

Is a situation in which two or more people or groups are trying to get something which not every one can have.

Competition for admission to the college is keen.

EFFICIENCY **n**

The case in which a given level of inputs is used to produce the maximum output possible. Alternatively, the situation in which a given output is produced at minimum cost.

In a pure market system, competition generates economic **efficiency** only when individuals know and must bear the true opportunity cost of their action.

EXTERNALITY **n**

A consequence of an economic activity that spills over to affect third parties.

Pollution is an **externality**.

FAILURE **n**

Lack of success.

That year there was a crop **failure**.

FINANCE **n**

The management of money, credit, banking and investments.

A private company will **finance** and build the pipeline.

FREE-RIDER **n**

A problem that arises when individuals presume that others will pay for public goods so that, individually, they can escape paying for their portion without causing a reduction in production.

We may all want to be **free-riders** if we believe that someone else will provide the commodity in question that we actually value.

GOVERNMENT-INHIBITED GOOD

A good that has been deemed socially undesirable through the political process.

Heroin, cigarettes, gambling, and cocaine are examples of **government-inhibited good**.

GOVERNMENT-SPONSORED GOOD

A good that has been deemed socially desirable through the political process. Museums are an example.

Sports stadiums, museums, and plays are examples of **government-sponsored goods**.

INHIBIT **v**

To put down by force or authority.

The drugs with which the animals are fed **inhibit** their development.

PROFIT **n**

The excess of total revenue over total cost during a specific period of time.

The cassette can be copied times and sold for a massive **profit**.

PUBLIC SPENDING **n**

Money spent by a government to provide services for its people.

The government is reducing **public spending**.

PUBLIC GOODS **n**

Goods which can be jointly consumed by many individuals simultaneously at no additional cost and with no reduction in quality.

National defense, police protection, and the legal system are examples of **public goods**.

REDISTRIBUTION **n**

Distributing again.

Income **redistribution** uses two systems: the progressive income tax and transfer payment.

REGULATION **n**

Rules made by government or other authority.

Regulations require that all school-age children be inoculated before entering public and private schools.

RESOURCES **n**

Things used to produce goods and services to satisfy people's wants.

In the steel product too many **resources** will be allocated to steel production.

RIVAL CONSUMPTION **n**

The recognition that individuals are rivals in consuming private goods because one person's consumption reduces the amount available for others to consume.

The principle of **rival consumption** does not apply to public goods which can be consumed jointly by many individuals simultaneously.

SPENDING **n**

Refers to the amount of money a government or other organization uses for buying or paying for things.

Departments must reduce their **spending** before new term commencement.

SPONSOR **n**

Person or organization that promotes or supports.

He is **sponsor** of the new art gallery.

STABILITY **n**

The state of being stable.

The biggest problem facing the relief is the lack of political **stability**.

SUBSIDIZE **n**

Paying port of a public service or an industry costs by government.

In our country the government **subsidizes** education.

TAXATION **n**

The system by which a government collects money from people and spends it on such things as defence, education, and so on.

Income redistribution can be carried out by a system of progressive **taxation**.

THIRD PARTIES **n**

Parties who are not directly involved in a given activity or transaction.

In the relationship between caregivers and patients, fees may be paid by **third parties** (insurance companies, government).

Vocabulary

Exercises 4.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. spending	a. income
2. failure	b. provide financial assistance
3. benefit	c. forbid
4. competition	d. supporter
5. subsidize	e. profit
6. regulation	f. inability to succeed
7. sponsor	g. partition
8. inhibit	h. expenditure
9. allocation	i. law
10. redistribution	j. contest
	k. act of apportioning again
	l. consumption

Public Spending

• What a Price System Can and Cannot do

Price system has many advantages. High on the list is economic proficiency. In its ideal form, a price system allows all resources to move from lower-valued uses to higher-valued uses via voluntary exchange, by which mutually advantageous trades take place. In a price system, consumers are sovereign; that is to say, they have the individual freedom to decide what they wish to purchase. Politicians and even business managers do not ultimately decide what is produced; consumers decide. Some proponents of the price system argue that this is its most important characteristic. Competition among sellers protects consumers from coercion by one seller, and sellers are protected from coercion by one consumer because other consumers are available.

• Correction for Externalities

In a pure market system, competition generates economic efficiency only when individuals know and must bear the true opportunity cost of their action. In some circumstances, the price that someone actually pays for a resource, good, or service is higher or lower than the opportunity cost that all of society pays for that same resource, good, or service.

• Externalities

Consider a hypothetical world in which there is no government regulation against pollution. You are living in a town that until now has had clean air. A steel mill moves into town. It produces steel and has paid for the inputs-land, labor, capital, and entrepreneurship. The price the mill charges for the steel reflects, in this example, only the costs that it incurs. In the course of production, however, the mill utilizes one input-clean air-by simple using it. This is indeed an input because in making steel, the furnaces emit smoke. The steel mill doesn't have to pay the cost of dirtying the air. Rather, it is the people in the community who incur that cost in the form of dirtier clothes, dirtier cars and houses, and more respiratory illnesses. The effect is similar to what would happen if the steel mill could take coal or oil or workers' services without paying for them. There is an externality, an external cost. Some of the costs associated with the production of the steel have "spilled over" to affect third parries, parties other than the buyer and the seller or the steel. A fundamental reason that air pollution creates external costs is that the air belongs to everyone and hence to no one in particular. Lack of clearly assigned property rights, or the rights of an owner to use and exchange property, prevents market prices from reflecting all the costs created by activities that generate spillovers onto third parties.

Why do some observers contend that negative externalities are associated with the growing use of digital billboards?

• Resource Misallocation of Externalities

When there are external costs, the market will tend to overallocate resources to the production of the good or service in question, for those goods or services are implicitly priced deceptively low. In the steel example, too many resources will be allocated to steel production, because the steel mill owners and managers are not required to take account of the external cost that steel production is imposing on the rest of society. In essence, the full cost of production is not borne by the owners and managers, so the price they charge the public for steel is lower than it would otherwise be. And, of course, the lower price means that buyers are willing and able to buy more. More steel is produced and consumed than if the sellers were to bear external costs.

In contrast, when there are external benefits, the price is too low to induce suppliers to allocate resources to the production of that good or service (because the demand, which fails to reflect the external benefits, is relatively too low). Thus, the market underallocates resources to producing the good or service. Hence, in a market system, too many of the goods that generate external costs are produced, and too few of the goods that generate external benefits are produced.

• How the Government Can Correct Negative Externalities

In theory, the government can take action to try to correct situations in which a lack of property rights allows third-party spillovers to create an externality. In the case of negative externalities, at least two avenues are open to government: special taxes and legislative regulation or prohibition.

Special Taxes

In our example of steel mill, the externality problem arises because using the air for waste disposal is costless to the firm but not to society. The government could attempt to tax the steel mill commensurate with the cost to third parties from smoke in the air. This, in effect, would be a pollution tax or on effluent fee. The ultimate effect would be to reduce the supply of steel and raise the price to consume, ideally making the price equal to the full cost of production to society.

Regulation

Alternatively, to correct a negative externality arising from steel production, the government could specify a maximum allowable rate of pollution. This regulation would require that the steel mill install pollution abatement equipment at its facilities, reduce its rate of output, or some combination of the two. Note that the government's job would not be simple, for it would have to determining the appropriate level of pollution, which would require extensive knowledge of both benefits and the costs of pollution control.

• How the Government Can Correct Positive Externalities

What can government do when the production of one good spills benefits over to third parties? It has several policy option: financing the production of the good or producing the good itself, subsidies (negative taxes), and regulation.

Government Financing and Production

If the positive externalities seem extremely large, the government has the option of financing the desired additional production facilities so that the "right" amount of the good will be produced. Consider inoculations against communicable diseases. The government could-and often does-financing campaigns to inoculate the population. It could (and does) even produce and operate inoculation centers where inoculations are given at no charge.

Subsidies

A subsidy is a negative tax; it is a payment made either to a business or to a consumer when the business produces or the consumer buys a good or a service. To generate more inoculations against communicable diseases, the government could subsidize everyone who obtains an inoculation by directly reimbursing those inoculated or by making payments to private firms that provide inoculations. Subsidies reduce the net price to consumers, thereby causing a larger quantity to be demanded. How are governments seeking to help society capture the external benefits of transportation services that keep elderly drivers off the roads?

Regulation

In some cases involving positive externalities, the government can require by law that individuals in the society undertake a certain action. For example, regulations require that all school-age children be inoculated before entering public and private schools. Some people believe that a basic school education itself generates positive externalities. Perhaps as a result of this belief, we have regulations-laws-that require all school-age children to be enrolled in a public or private school.

- **Providing Public Goods**

The goods used in our examples up to this point have been private goods. When I eat a cheeseburger, you cannot eat the same one. So you and I are rivals for that cheeseburger, just as much as contenders for the title of world champion are. When I use a DVD player, you cannot play some other disc at the same time. When I use the services of an auto mechanic, that person cannot work at the same time for you. That is the distinguishing feature of private goods-their use is exclusive to the people who purchase or rent them. The principle of rival consumption applies to all private goods by definition. Rival consumption is easy to understand. Either you use a private good or I use it.

There is an entire class of goods that are not private goods. There are called public goods. The principle of rival consumption does not apply to them. They can be consumed jointly by many individuals simultaneously, and no one can be excluded from consuming these goods even if they fail to pay to do so. National defense, police protection, and the legal system are examples of public goods.

• Characteristics of Public Goods

Two fundamental characteristics of public goods set them apart from all other goods:

1. Public goods can be used by more and more people at no additional opportunity cost and without depriving other of any of the services of the goods. One funds have been spent on national defense, the defense protection you receive does not reduce the amount of protection bestowed on anyone else. The opportunity cost of your receiving national defense once is in place is zero because one national defense is in place to protect you, it also protect others.
2. It is difficult to design a collection system for a public good on the basis of how much individuals use it. Nonpayers can often utilize a public good without incurring any monetary cost, because the cost of excluding them from using the good is so high. Those who provide the public good find that it is not cost-effective to prevent nonpayers from utilizing it. For instance, taxpayers who pay to provide national defense typically do not incur the costs that would

be entailed in excluding nonpayers from benefiting from national defense.

One of the problems of public goods is that the private sector has a difficult, if not impossible, time providing them. Individuals in the private sector have little or no incentive to offer public goods. It is difficult for them to make a profit doing so, because nonpayers cannot be excluded. Consequently, true public goods must necessarily be provided by government. Note, though, that economists do not categorize something as a public good simply because the government provides it.

- **Free Riders**

The nature of public goods leads to the free-rider problem, a situation in which some individuals take advantage of the fact that others will assume the burden of paying for public goods such as national defense. Suppose that citizens were taxed directly in proportion to how much they tell an interviewer that they value national defense. Some people who actually value national defense will probably tell interviewers that it has no value to them-they don’t want any of it. Such people are trying to be free riders. We may all want to be free riders if we believe that someone else will provide the commodity in question that we actually value.

The free-rider problem often arises in connection with sharing the burden of international defense. A country may choose to belong to a multilateral defense organization, but then consistently attempt to avoid contributing funds to the organization. The nation knows it would be defended by others if the organization were attacked but would rather not pay for such defense. In short, it seeks a free ride.

Vocabulary and Comprehension Exercise

Exercise 4.2

Fill in the blanks with appropriate words from the following list.

costs	transfer	financing	rival
consumption	externalities	income	charged
government-inhibited		benefits	competition
taxation	legal system	economywide stability	
subsidizing	political	public	regulation
opportunity cost		government-sponsored	

1. External ………. lead to an overallocation of resources to the specific economic activity. Two possible ways of correcting these spillovers are ………. and ……… .

2. External ……….. result in an underallocation of resources to the specific activity. Three possible government corrections are ………. the production of the activity, ………… private firms or consumers to engage in the activity, and regulation.

3. The economic activities of government include (1) correcting for …………., (2) providing a ………….., (3) promoting …………., (4) producing ………… goods, and (5) ensuring economywide stability.

4. The principle of …………… does not apply to pubic goods as it does to private goods.

5. Public goods have two characteristics: (1) One they are produced, there is no additional ………….. when additional consumers use them, because your use of a public good does not deprive others of its simultaneous use; and (2) consumers cannot conveniently be …………on the basis of use.

6. Political, or normative, activities of the government include the provision and regulation of …………. and ………… goods and income redistribution.

7. Government-sponsored and government-inhibited goods do not have any inherent characteristics that qualify them as such; rather, collectively, through the ………… process, we make judgments about which goods and services are "good" for society and which are "bad."
8. Income redistribution can be carried out by a system of progressive taxation, coupled with ………. payments, which can be mad in money or in kind, such as food stamps and Medicare.

Comprehension Exercises

Exercise 4.3

1. Which one is the most important role of the price system?
   a. positive externalities
   b. proficiency
   c. misallocation
   d. negative externalities

2. Air pollution creates ………. because the air belongs to everyone and hence to no one in particular.
   a. external benefit
   b. external cost
   c. positive externality
   d. none of the above

3. How the government can correct negative externalities?
   a. Government Financing and Production
   b. Subsidies
   c. Government production
   d. Special Taxes

4. The ……… would require that the steel mill install pollution abatement equipment at its facilities, reduce its rate of output, or some combination of the two.
   a. Special Taxes
   b. Government Financing

c. Regulation
d. Subsidies

5. In account of text, ………. is a payment made either to a business or to a consumer when the business produces or the consumer buys a good or a service.
a. Tax
b. Subsidy
c. Cost
d. Income

6. Which one is not an example of a public good?
a. National defense
b. Police protection
c. Automobile
d. Highway

Exercise 4.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …… In a price system, consumers are sovereign; that is to say, they have the individual freedom to decide what they wish to purchase.

2. …….. When there are external benefits, the price is too high to induce suppliers to allocate resources to the production of that good or service.

3. …….. In order to correct a negative externality arising from steel production, the government could specify a maximum allowable rate of pollution.

4. ……… Subsidies reduce the net price to consumers, thereby causing a lower quantity to be demanded.

5. ………. Private goods can be consumed jointly by many individuals simultaneously, and no one can be excluded from consuming these goods even if they fail to pay to do so.
6. ……… It is difficult to design a collection system for a public good on the basis of how much individuals use it.

Exercise 4.5

After reading the text, try to provide full answers to the following questions.

1. Define the externality via a practical example in your society.
2. How the government can correct negative externalities?
3. How the government can correct positive externalities?
4. Summarize the characteristics of public goods.
5. Many people who do not smoke cigars are bothered by the odor of cigar smoke. In the absence of any government involvement in the market for cigars, will too many or too few cigars be produced and consumed? Form society's point of view, will the market price of cigars be too high or too low?
6. Government offers to let a number of students at a public school transfer to a private school under two conditions: It will transfer to the private school the same per-pupil subsidy it provides the public school, and the private school will be required to admit the students as a below-market net tuition rate. Will the economic outcome be the same as the one that would have arisen if the government instead simply provided students with grants to cover the current market tuition rate at the private school? (Hint: Does it matter if schools receive payments directly from the government or from consumers?)

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

The Political Functions of Government

At least two function of government are political or normative functions rather than economic ones. These two areas are (1) the provision and regulation of government-sponsored and government inhibited goods and (2) income redistribution.

Government-Sponsored and Government-Inhibited Goods

Through political processes, governments often determine that certain goods possess special merit and seek to promote their production and consumption. A government-sponsored good is defined as any good that the political process has deemed socially desirable. (Note that nothing inherent in any particular good makes it a government-sponsored good. The designation is entirely subjective). .Examples of government-sponsored goods in our society are sports stadiums, museums, and plays. In these areas, the government's role is the provision of these goods to the people in society who would not otherwise purchase them at market clearing prices or who would not purchase an amount of them judged to be sufficient. This provision may take the form of government production and distribution of the goods. It can also take the form of reimbursement for spending on government-sponsored goods or subsidies to producers or consumers for part of the goods' costs. Governments do indeed subsidize such goods as professional sports, museums, and plays. In most cases, those goods would not be so numerous without subsidization.

Government inhibited goods are the opposite of government-sponsored goods. They are goods that, through the political process, have been deemed socially undesirable. Heroin, cigarettes, gambling, and cocaine are examples. The government exercises its role with respect to these goods by taxing, regulation, or prohibiting their manufacture, sale, and use. Governments justify the relatively high taxes on tobacco by declaring that they are socially undesirable. The best-known example of government exercise of power in this area is the stance against certain psychoactive drugs. Most psychoactives are either expressly prohibited, as is the case for heroin, cocaine, and opium, or heavily regulated, as in the case of prescription psychoactives.

Income Redistribution

Another relatively recent political function of government has been the explicit redistribution of income. This redistribution uses two systems: the progressive income tax and transfer payment. Transfer payments are payments made to individuals for which no services or goods are rendered in return. The two primary money transfer payments in our system are social security old-age and disability benefits and unemployment insurance benefits. Income redistribution also includes a large amount of income transfers in kind, rather than money transfers. Some income transfers in kind are food stamps, Medicare and Medicaid, government health care service, and subsidized goods. The government has also engaged in other activities as a form of redistribution of income. For example, the provision of public education is at least in part an attempt to redistribute income by making sure that the poor have access to education.

Keywords

Circumstances	اوضاع، مقتضیات	Profit	سود
Coercion	تحمیل، اجبار	Public	عمومی
Competition	رقابت	Redistribution	توزیع مجدد
Efficiency	کارایی	Regulation	مقررات، قانون
Externality	اثر خارجی	Sovereign	مسلط
Failure	شکست، عدم موفقیت	Spending	مخارج
Finance	تامین مالی	Sponsor	تضمین‌کننده، حامی
Generate	بوجود آوردن	Subsidy	یارانه
Inhibit	مانع شدن	Tax	مالیات
Misallocation	تخصیص نادرست	Trade	مبادله
Private	شخصی		

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 4-1

1. h	2. f	3. e	4. j
5. b	6. i	7. d	8. c
9. g	10. k		

Exercise 4-2

1. costs, taxation, regulation
2. benifits, financing, subsidizing
3. externalities, legal system, competition, public consumption
4. rival
5. opportunity cost, charged
6. government-sponsored, government-inhibited
7. political
8. transfer

Exercise 4-3

1. b	2. b	3. d	4. c
5. b	6. c		

Exercise 4-4

1. T	2.F	3. T	4. F
5. F	6. T		

Exercise 4-5

1. Externality is a consequence of an economic activity that spills over to affect third parties. Pollution is an externality.
2. In theory, the government can take action to try to correct situations in which a lack of property rights allows third-party spillovers to create an externality. In the case of negative externalities, at least

two avenues are open to government: special taxes and legislative regulation or prohibition.

3. When the production of one good spills benefits over to third parties, government has several policy option: financing the production of the good or producing the good itself, subsidies (negative taxes), and regulation.

4. a) Public goods can be used by more and more people at no additional opportunity cost and without depriving other of any of the services of the goods. b) It is difficult to design a collection system for a public good on the basis of how much individuals use it.

5. In the absence of laws forbidding cigar smoking in public places, people who are bothered by the odor of cigar smoke will experience costs not borne by cigar producers. Because the supply of cigars will not reflect these costs, from society’s perspective the market cigar supply curve will be in a position too far to the right. The market price of cigars will be too low, and too many cigars will be produced and consumed.

6. No, outcome will be different. If the government had simply provided grants to attend private schools at the current market tuition rate, parents and students receiving the grants would have paid a price equal to market valuation of the last unit of educational services provided. Granting a subsidy to private schools allows the private schools to charge parents and students a price less than the market price. Private schools thereby will receive a higher than market price for last unit of educational services they provide. Consequently, they will provide a quantity of educational services in excess of the market equilibrium quantity.

Chapter 5

Unemployment and Inflation

General Objectives

This unit has been designed to help you to:

- Discuss the types of unemployment.
- Distinguish between nominal and real interest rates.
- Explain the inflation and the purchasing power of money.
- Evaluate who loses and who gains from inflation.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

ANTICIPATED INFLATION **n**

The inflation rate that we believe will occur; when it does, we are in a situation of fully anticipated inflation.

The real interest is defined as the nominal interest minus the **anticipated inflation**.

CREDITOR **n**

Some one to whom an obligation exists.

The government said to owe hundreds of millions of dollars to foreign **creditors**.

CYCLICAL UNEMPLOYMENT **n**

Unemployment resulting from business recessions that occur when aggregate (total) demand is insufficient to create full employment.

Economic policymakers attempt, through their policies, to reduce **cyclical unemployment** by keeping business activity on an even keel.

DEBTOR **n**

One who is obliged to another.

Commercial banks should reduce the debt owed by **debtor** countries by thirty percent.

ENTRANT **n**

Person who officially enters a competition or institution.

Each **entrant** plays the game of their choice.

FIRE **v**

Dismiss from a job.

Psychological researchers believe that being **fired** creates as much stress as the death of a close friend.

FRICTIONAL UNEMPLOYMENT **n**

Unemployment due to fact that workers must search for appropriate job offers. This takes time, and so they remain temporary unemployed.

To eliminate **frictional unemployment**, we would have to prevent workers from leaving their present jobs until they had already lined up other jobs at which they would start working immediately.

HOUSEHOLD **n**

All the people in a family or group who live together in a house.

Consumers are part of the **household** sector.

INFLATION **n**

A sustained increase in the average of all prices of goods and services in an economy.

The prices of electronic equipment have dropped dramatically since the 1960s, even though there has been general **inflation**.

INTEREST RATE **n**

The percentage of a sum of money charged for its use.

The **interest rate** varies according to what happens in the economy.

JOB LEAVER **adj**

An individual in labor force who quits voluntarily.

Job leavers are type of individuals who are without work.

JOB LOSER **adj**

An individual in the labor force whose employment was involuntarily terminated.

Job losers are type of individuals who are without work.

NEW ENTRANT **adj**

An individual who has ever held a full-time job lasting two weeks or longer but is now seeking employment.

New entrants are type of individuals who are without work.

NOMINAL **adj**

Describe a position or characteristic which someone or something is supposed to have but which it does not have in reality.

The **nominal** value of anything is simply its price expressed in today's Rials.

PURCHASING POWER **n**

The value of money for buying goods and services.

If your money income stays the same but the price of one good that you are buying goes up, your effective **purchasing power** falls, and vice versa.

REAL **adj**

Something that actually exist and is not imagined, invented, or theoretical.

The **real** value of anything is its value expressed in purchasing power, which varies with the overall price level.

REENTRANT **adj**

An individual who used to work full-time but left the labor force and has now reentered it looking for a job.

Reentrants are type of individuals who are without work.

SEASONAL UNEMPLOYMENT **n**

Unemployment resulting from the seasonal pattern of work in specific industries.

Seasonal unemployment is usually due to seasonal fluctuations in demand or to changing weather conditions that render work difficult, if not impossible, as in the agriculture, construction, and tourist industries.

STRUCTURAL UNEMPLOYMENT n

Unemployment resulting from a poor match of workers' abilities and skills with current requirements of employers.

Structural changes in our economy cause some workers to become unemployed for very long period of time because they cannot find jobs that use their particular skills. This is called **structural unemployment**.

UNANTICIPATED INFLATION n

Inflation at a rate that comes as surprise, either higher or lower than the rate anticipated.

In most situations, **unanticipated inflation** benefits borrowers because the nominal interest rate they are being charged does not fully compensate creditors for the inflation that actually occurred.

UNEMPLOYMENT n

The total number of adults (aged 16 years or older) who are willing and able to work but have not found a job.

The government is concerned about the level of **unemployment** in our country.

VOLUNTARILY adv

Actions that you choose to do, rather than have been forced to do.

Attendance at the parade was **voluntarily**.

Vocabulary

Exercises 5.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. unemployment	a. moneylender
2. interest rate	b. rise in prices
3. inflation	c. state of not being employed
4. fire	d. rate of money that is paid for a financial service
5. debtor	e. expect
6. voluntarily	f. cost
7. entrant	g. dismiss from a job
8. household	h. not by force
9. anticipate	i. one who is obliged to another
10. creditor	j. of or pertaining to a home or family
	k. one who becomes a member
	l. income

Unemployment and Inflation

Unemployment is normally defined as the number of adults who are actively looking for work but do not have a job. Unemployment creates a cost to the entire economy in terms of lost output. On a more personal level, the state of being unemployed often results in hardship and failed opportunities as well as a lack of self-respect. Psychological researchers believe that being fired creates as much stress as the death of a close friend. The numbers that we present about unemployment can never fully convey its true cost to the people of this or any other nation.

- **Categories of Individuals Who Are Without Work**

An unemployed individual will fall into any of our categories:

1. A job loser, whose employment was involuntarily terminated or who was laid off.
2. A reentrant, who worked a full-time job before but has been out of the labor force.
3. A job leaver, who voluntarily ended employment.
4. A new entrant, who has never worked a full-time job for two weeks or longer.

- **The Major Types of Unemployment**

Unemployment has been categorized into four basic types: frictional, structural, cyclical, and seasonal.

Frictional Unemployment

Unemployment due to the fact that workers must search for appropriate job offers. This takes time, and so they remain temporarily unemployed. The continuous flow of individuals from job to job and in and out of employment is called frictional unemployment. There will always be some frictional unemployment as resources are redirected in the economy, because job-hunting costs are never zero, and workers never have full information about available jobs. To eliminate frictional unemployment, we would have to prevent workers from leaving their present jobs until they had already lined up other jobs at which they would start working immediately. And we would have to guarantee firs-time job seekers a job before they started looking.

Structural Unemployment

Structural changes in our economy cause some workers to become unemployed for very long period of time because they cannot find jobs that use their particular skills. This is called structural unemployment. Structural unemployment is not caused by general business fluctuations, although business fluctuations may affect it. And unlike frictional unemployment, structural unemployment is not related to the movement of workers from low-paying to high-paying jobs. At one time, economists thought about structural unemployment only from the perspective of workers. The concept applied to workers who did not have the ability, training, and skills necessary to obtain available jobs. Today, it still encompasses these workers. In addition, however, economists increasingly look at structural unemployment from the viewpoint of employers, many of whom face government mandates requiring them to take such steps as providing funds for social insurance programs for their employees and announcing plant closing months or even years in advance. There is now considerable evidence that government labor market policies influence how many positions business wish to create, thereby affecting structural unemployment.

Cyclical Unemployment

Cyclical unemployment is related to business fluctuations. It is defined as unemployment associated with changes in business conditions-primarily recessions and depressions. The way to lessen cyclical unemployment would be to reduce the intensity, duration, and frequency of downturns of business activity. Economic policymakers attempt, through their policies, to reduce cyclical unemployment by keeping business activity on an even keel.

Seasonal unemployment

Seasonal unemployment comes and goes with seasons of the year in which the demand for particular jobs rises and falls. Construction workers can often work only during the warmer months; they are seasonally unemployed during the winter. Summer resort workers can usually get jobs in resorts only during summer season. They, too, become seasonally unemployed during the winter; the opposite is true for ski resort workers.

- **Inflation**

We define inflation as an upward movement in the average level of prices. Notice that these definitions depend on the average level of prices. This means that even during a period of inflation, some prices can be falling if other prices are rising at a faster rate. The prices of electronic equipment have dropped dramatically since the 1960s, even though there has been general inflation.

Inflation and the Purchasing Power of Money

The value of a Rial does not stay constant when there is inflation. The value of money is usually talked about in term of purchasing power. A Rial’s purchasing power is the real goods and services that it can buy. Consequently, another way of defining inflation is as a decline in the purchasing power of money. The faster the rate of inflation, the greater the rate of decline in the purchasing power of money. One way to think about inflation and the purchasing power of money is to discuss Rial values in terms of nominal versus real values. The nominal value of anything is simply its price expressed in today’s Rials. In contrast, the real value of anything is its value expressed in purchasing power, which varies with the overall price level. Let’s say that you received a 50000 Rials bill from your grandparents this year. One year from now, the nominal value of that bill will still be 50000 Rials. The real value will depend on what the purchasing power of money is after one year's worth of inflation. Obviously, if there is inflation during the year, the real value of that 50000 Rials bill will have diminished. For example, if you keep the 50000 Rials bill in your pocket for a year during which the rate of inflation is 3 percent, at the end of the year you will have to come up with 1500 Rials more to buy the same amount of goods and services that the 50000 Rials bill can purchase today.

Anticipated versus Unanticipated Inflation

To determine who is hurt by inflation and what the effects of inflation are in general, we have to distinguish between anticipated and unanticipated inflation. We will see that the effects on individuals and the economy are vastly different, depending on which type of inflation exists.

- Anticipated inflation is the rate of inflation that most individuals believe will occur. If the rate of inflation this year turns out to be 5 percent, and that's about what most people thought it was going to be, we are in a situation of fully anticipated inflation.
- Unanticipated inflation is inflation that comes as a surprise to individuals in the economy. For example, if the inflation rate in a particular year turns out to be 10 percent when on average people thought it was going to be 3 percent, there was unanticipated inflation-inflation greater than anticipated.

Some of problems caused by inflation arise when it is unanticipated, because then many people are unable to protect themselves from its ravages. Keeping the distinction between anticipated and unanticipated inflation in mind; we can easily see the relationship between inflation and interest rates.

Inflation and Interest Rates

Let's start in a hypothetical world in which there is no inflation and anticipated inflation is zero. In that world, you may be able to borrow funds-to buy a house or a car, for example-at a nominal rate of interest of, say, 6 percent. If you borrow the funds to purchase a house or a car and your anticipation of inflation turns out to be accurate, neither you nor the lender will have been fooled. Each Rial you pay back in the years to come will be just as valuable in terms of purchasing power as the Rial that you borrowed.

What you ordinarily want to know when you borrow is the real rate of interest that you will have to pay. The real rate of interest is defined as the nominal rate of interest minus the anticipated rate of inflation. In effect, we can say that the nominal rate of interest is equal to the real rate of interest plus an inflationary premium to take account of anticipated inflation. That inflationary premium covers depreciation in the purchasing power of the Rials repaid by borrower. (Whenever there are relatively high rates of anticipated inflation, we must add an additional factor to the inflationary premium-the product of the real of interest times the anticipated rate of inflation. Usually, this last term is omitted because the anticipated rate of inflation is not high enough to make much of a difference.)

Vocabulary and Comprehension Exercise

Exercises 5.2

Fill in the blanks with appropriate words from the following list.

purchasing power		structural	resource
greater	unemployed	frictional	less
labor force	natural		

1. In account of text, …………persons are adults who are willing and able to work and are actively looking for a job but have not found one.
2. The unemployment rate is computed by dividing the number of unemployed by the total …………….., which is equal to those who are employed plus those who are unemployed.

3. In account of text, …………… unemployment occurs because of transaction costs in the labor market. For example, workers do not have full information about vacancies and must search for jobs.
4. In account of text, …………… unemployment occurs when there is a poor match of workers' skills and abilities with available jobs, perhaps because workers lack appropriate training or government labor rules reduce firms' willingness to hire.
5. The levels of frictional and structural unemployment are used in part to determine our (somewhat arbitrary) measurement of the ………….. rate of unemployment.
6. Whenever inflation is ……….. than anticipated, creditors lose and debtors gain. Whenever the rate of inflation is ……….. than anticipated, creditors gain and debtors lose.
7. Holders of cash lose during periods of inflation because the ……………. of their cash depreciates at the rate of inflation.
8. Households and businesses spend resources in attempting to protect themselves against the prospect of inflation, thus imposing a ……….. cost on the economy.

Comprehension Exercises

Exercise 5.3

1. A ……… worked a full-time job before but has been out of the labor force.
   a. job loser
   b. reentrant
   c. job leaver
   d. new entrant
2. In account of text, ……….. is unemployment resulting from a poor match of workers' abilities and skills with current requirements of employers.
   a. Frictional
   b. Structural

c. Cyclical
d. Seasonal

3. In account of text, ……….. is unemployment resulting from business recessions that occur when aggregate demand is insufficient to create full employment.

a. Natural
b. Structural
c. Cyclical
d. Seasonal

4. In account of text, ……….. is unemployment that is estimated to prevail in long-run macroeconomic equilibrium, when all workers and employers have fully adjusted to any changes in the economy.

a. Natural
b. Structural
c. Cyclical
d. Seasonal

5. We define inflation as ……………

a. an upward movement in the average level of prices.
b. a decline in the purchasing power of money.
c. a sustained increase in the average of all prices of goods and services in an economy.
d. all of the above.

6. The real rate of interest is defined as the ……. rate of interest minus the …….. rate of inflation.

a. real, anticipated
b. nominal, anticipated
c. real, unanticipated
d. nominal, unanticipated

Exercise 5.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. ……The continuous flow of individuals from job to job and in and out of employment is called frictional unemployment.
2. …… Economic policymakers attempt, through their policies, to reduce frictional unemployment by keeping business activity on an even keel.
3. ……. Construction workers can often work only during the warmer months; they are cyclical unemployed during the winter.
4. …… A Rial's purchasing power is the real goods and services that it can buy.
5. ……. If the rate of inflation this year turns out to be 10 percent, and that's about what most people thought it was going to be, we are in a situation of fully unanticipated inflation.
6. …… the nominal rate of interest is equal to the real rate of interest plus an inflationary premium to take account of anticipated inflation.

Exercise 5.5

After reading the text, try to provide full answers to the following questions.

1. Who are without work?
2. What are the major types of unemployment?
3. What is the relationship between inflation and purchasing power of money?
4. Describe anticipated and unanticipated inflation.
5. What are the real and nominal rates of interest?
6. A nation's frictional unemployment rate is 1 percent; seasonal unemployment does not exist in this country. Its cyclical rate of unemployment is 3 percent, and its structural unemployment rate is 4 percent. What is this nation's overall rate of unemployment? What is its natural rate of unemployment?

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Does Inflation Necessarily Hurt Everyone?

Most people think that inflation is bad. After all, inflation means higher prices, and when we have to pay higher prices, are we not necessarily worse off? The truth is that inflation affects different people differently. Its effects also depend on whether it is anticipated or unanticipated.

Unanticipated Inflation: Creditors Lose and Debtors Gain

In most situations, unanticipated inflation benefits borrowers because the nominal interest rate they are being charged does not fully compensate creditors for the inflation that actually occurred. In other words, the lender did not anticipate inflation correctly. Whenever inflation rates are underestimated for the life of a loan, creditors lose and debtors gain. Periods of considerable unanticipated (higher than anticipated) inflation occurred in late 1960s and all of the 1970s. During those years, creditors lost and debtors gained.

Protecting Against Inflation

Lenders attempt to protect themselves against inflation by raising nominal interest rates to reflect anticipated inflation. Adjustable-rate mortgages in fact do just that: The interest rate varies according to what happens to interest rates in the economy. Workers can protect themselves from inflation by obtaining cost-of-living adjustments (COLAs), which are automatic increases in wage rates to take account of increases in the price level. To the extent that you hold non-interest-bearing cash, you will be lose because of inflation. If you have put 1000000 Rials in a mattress and the inflation rate is 5 percent for the year, you will have lost 5 percent of the purchasing power of that 1000000 Rials. If you have your funds in a non-interest-bearing checking account, you will suffer the same fate. Individuals attempt to reduce the cost of holding cash by putting it into interest-bearing accounts, a wide variety of which often pay nominal rates of interest that reflect anticipated inflation.

The Resource Cost of Inflation

Some economists believe that the main cost of inflation is the opportunity cost of resources used to protect against distortions that inflation introduces as firms attempt to plan for the long run. Individuals have to spend time and resources to figure out ways to adjust their behavior in case inflation is different from what it has been in the past. That may mean spending a longer time working out more complicated contracts for employment, for purchases of goods in the future, and for purchases of raw materials.

Inflation requires that price lists be changed. This is called the repricing, or menu, cost of inflation. The higher the rate of inflation, the higher the repricing cost of inflation, because prices must be changed more often within a given period of time.

Keywords

Business fluctuations	نوسانات تجاری	Household	خانوار
Creditor	بستانکار	Inflation	تورم
Cyclical	ادواری	Interest rate	نرخ بهره
Debtor	بدهکار	Natural	طبیعی
Depreciation	کاهش بها، استهلاک	Seasonal	فصلی
Diminish	تقلیل یافتن	Structural	ساختاری
Employer	کارفرما	Temporarily	بطور موقت
Entrant	وارد شونده	Unemployment	بیکاری
Fire	اخراج کردن	Vacancy	فرصت شغلی
Frictional	اصطکاکی	Voluntarily	داوطلبانه

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 5-1

1. c	2. d	3. b	4. g
5. i	6. h	7. k	8. j
9. e	10. a		

Exercise 5-2

1. unemployed	2.labor force	3. frictional	4. structural
5. natural	6. greater, less	7. purchasing power	8. resource

Exercise 5-3

1. b	2. b	3. c	4. a
5. d	6. b		

Exercise 5-4

1. T	2.F	3. F	4. T
5. F	6. T		

Exercise 5-5

1. Below is the categories of individuals who are without work

a. A job loser, whose employment was involuntarily terminated or who was laid off.

b. A reentrant, who worked a full-time job before but has been out of the labor force.

c. A job leaver, who voluntarily ended employment.

d. A new entrant, who has never worked a full-time job for two weeks or longer.

2. Unemployment has been categorized into four basic types: frictional, structural, cyclical, and seasonal.

3. The faster the rate of inflation causes the greater the rate of decline in the purchasing power of money. Therefore, there is the inverse relationship between the inflation and purchasing power of money.

4. Anticipated inflation is the inflation rate that we believe will occur; when it does, we are in a situation of fully anticipated inflation. And unanticipated inflation is inflation at a rate that comes as surprise, either higher or lower than the rate anticipated.

5. The nominal value of anything is simply its price expressed in today's Rials. In contrast, the real value of anything is its value expressed in purchasing power, which varies with the overall price level. Hence, the real rate of interest is defined as the nominal rate of interest minus the anticipated rate of inflation. In effect, we can say that the nominal rate of interest is equal to the real rate of interest plus an inflationary premium to take account of anticipated inflation.

6. The overall unemployment rate is 8 percent, and the natural rate of unemployment is 5 percent.

Chapter 6

Measuring the Economy's Performance

General Objectives

This unit has been designed to help you to:

- Describe the circular flow of income and output.
- Define gross domestic product (GDP).
- Explain the inclusions that should not and do not get included in measure of GDP.
- Explain the expenditure approach to computing GDP.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

CAPITAL GOODS **n**

Durable goods having an expected service life or more than three years that are used by businesses to produce other goods and services.

A produce durable, or a **capital good**, is simply a good that is purchased not to be consumed in its current form but to be used to make other goods and services.

DURABLE CONSUMER GOODS **n**

Consumer goods that have a life span of more than three years.

As households or as individuals, we spend our income through consumption expenditure (C), which falls into three categories: **durable consumer goods**, nondurable consumer goods, and services

EXPORT **n**

The sale and sending of goods to another country.

The **export** of military equipments is already forbidden.

EXPENDITURE APPROACH **n**

Computing GDP by adding up all Rial value at current market prices of all final goods and services.

To derive GDP using the **expenditure approach**, we must look at each of the separate components of expenditures and then add them together.

FINAL GOODS AND SERVICES **n**

Goods and services that are at their final stage of production and will not be transformed into yet other goods or services. For example, wheat ordinarily is not considered a final good because it is usually used to make a final good, bread.

Total income is also defined as the annual cost of producing the entire output of **final goods and services**.

FIXED INVESTMENT **n**

Purchases by businesses of newly produced produce durables, or capital goods, such as production machinery and office equipment.

The purchase of equipment and factories-capital goods-is called **fixed investment**.

GROSS DOMESTIC PRODUCT (GDP) **n**

The total market value of all final goods and services produced during a year by factors of production located within a nation's borders.

The value of a newly built road is considered equal to its construction cost and is included in the **GDP** for the year it was built.

INTERMEDIATE GOODS **n**

Goods used up entirely in the production of final goods.

Grain is an **intermediate good**.

INVENTORY INVESTMENT **n**

Changes in the stocks of finished goods and goods in process, as well as changes in the raw materials that businesses keep on hand.

Whenever inventories are decreasing, **inventory investment** is negative; whenever they are increasing, **inventory investment** is positive.

INVESTMENT **n**

Any use of today's resources to expand tomorrow's production or consumption.

The layperson's notion of **investment** often relates to the purchase of stocks and bonds.

NONDURABLE CONSUMER GOODS **n**

Consumer goods that are used up within three years.

Food and gasoline are examples of **nondurable consumer goods**.

MEASURING **n**

The act or process of assigning numbers to phenomena according to a rule.

The expenditure approach to **measuring** GDP requires that we add up consumption expenditures.

OWNERSHIP **n**

The state of owning something.

In some countries there is the public **ownership** of land.

OUTPUT **n**

The amount of something produced by a person, machine, or industry.

Macroeconomics deals with aggregates, or totals-such as total **output** in an economy.

PERFORMANCE **n**

Process or manner of functioning or operating.

Britain's poor economic **performance** caused to high rate of unemployment.

SECURITIES **n**

Special certificates bought as an investment.

Foreigners helped finance the budget deficit by buying government **securities**.

SERVICES **n**

Mental or physical labor or help purchased by consumers.

Assistance of physicians, lawyers, dentists, repair personnel, housecleaners, educators, retailers, and wholesalers are examples of **services**.

TOTAL INCOME **n**

The yearly amount earned by the nation's resources (factors of production).

Total income includes wages, rent, interest payments, and profits that are received by workers, landowners, capital owners, and entrepreneurs, respectively.

TRANSACTION **n**

A business deal, usually involving buying and selling something.

An oil **transaction** requires both a buyer and a seller.

VALUE ADDED **n**

The Rial value of an industry's sales minus the value of intermediate goods (for example, raw materials and parts) used in production.

Value added is the amount of Rials value contributed to a product at each stage of its production.

WAGE **n**

Something that is paid to someone for work he has done.

The poorly paid worker's **wage** has not increased for two years.

Vocabulary

Exercises 6.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. performance	a. cost
2. measure	b. stocks
3. output	c. possession
4. wage	d. money
5. transaction	e. capital invested
6. inventory	f. earning
7. export	g. accomplishment
8. ownership	h. calculate
9. securities	i. business
10. investment	j. production
	k. list of assets
	l. sell overseas

Measuring the Economy's Performance

- **The Simple Circular Flow**

The concept of a circular flow of income (ignoring taxes) involves two principles:

1. In every economic exchange, the seller receives exactly the same amount that the buyer spends.
2. Goods and services flow in one direction and money payments flow in the other.

In the simple economy shown in Figure 6-1, there are only businesses and households. It is assumed that businesses sell their entire output in the current period to households and that households spend their entire income in the current period on consumer products.

Households receive their income by selling the use of whatever factors of production they own, such as labor services.

Profit

We have indicated in Figure 6-1 that profit is a cost of production. You might be under the impression that profits are not part of the cost of producing goods and services, but profits are indeed a part of this cost because entrepreneurs must be rewarded for providing their services or they won't provide them. Their reward, if any, is profit. The reward-the profit-is included in the cost of the factors of production. If there were no expectations of profit, entrepreneurs would not incur the risk associated with the organization of productive activities. That is why we consider profits a cost of doing business.

Total Income or Total Output

The arrow that goes from businesses to households at the bottom of Figure 6-1 is labeled "Total income". What would be a good definition of total income? If you answered "the total of all individuals' income", you would be right. But all income is actually a payment for something, whether it be wages paid for labor services, rent paid for the use of land, interest paid for the use of capital, or profits paid to entrepreneurs. It is the amount paid to the resource suppliers. Therefore, total income is also defined as the annual cost of producing the entire output of final goods and services.

The arrow going from households to businesses at the top of the figure represents the Rial value of output in the economy. This is equal to the total monetary value of all final goods and services for this simple economy. In essence, it represents the total business receipts from the sale of all final goods and services produced by businesses and consumed by households. Business receipts are the opposite side of household expenditures. When households purchase goods and services, those payments become a business receipt. Every transaction, therefore, simultaneously involves an expenditure and a receipt.

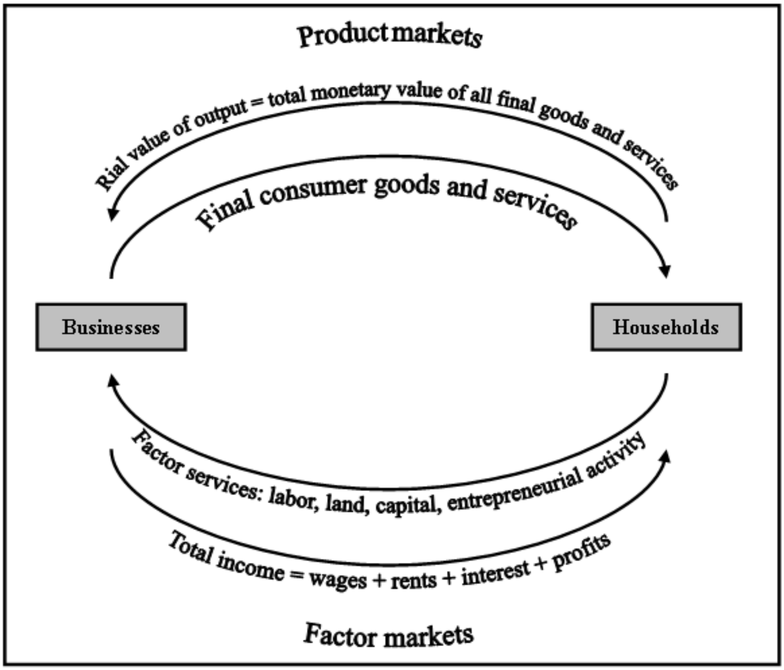

Figure 6-1. The Circular Flow of Income and Product

Product Markets

Transactions in which households buy goods take place in the product markets-that's where households are the buyers and businesses are the sellers of consumer goods. Product market transactions are represented in the upper loops in Figure 6-1. Note that consumer goods and services flow to household demanders, while money flow in the opposite direction to business suppliers.

Factor Markets

Factor market transactions are represented by the lower loops in Figure 6-1. In the factor market, households are the sellers; they sell resources such as labor, land, capital, and entrepreneurial ability. Businesses are the buyers in factor markets; business expenditures represent receipts or, more simply, income for households. Also, in the lower loops of Figure 6-1, factor services flow from households to businesses, while the money paid for these services flows in the opposite direction from businesses to households. Observe also the flow of money (counterclockwise) from households to businesses and back again from businesses to households: It is an endless circular flow.

- **Gross Domestic Product (GDP)**

Gross domestic product (GDP) represents the total market value of the nation’s annual final product, or output, produced by factors of production located within national borders. We therefore formally define GDP as the total market value of all final goods and services produced in an economy during a year. We are referring here to the value of a flow of production. A nation produces at a certain rate, just as you receive income at a certain rate. Your income flow might be at a rate of 50000000 Rials per year. Suppose you are told that someone earns 10000000 Rials. Would you consider this a good salary? There is no way to answer that question unless you know whether the person is earning 10000000 Rials per month or per week or per day. Thus, you have to specify a time period for all flows. Income received is a flow. You must contrast this with, for example, your total accumulated savings, which are a stock measured at a point in time, not over time. Implicit in just about everything we deal with in this chapter is a time period-usually one year. All the measures of domestic product and income are specified as rates measured in Rials per year.

Stress on Final Output

GDP does not count intermediate goods (goods used up entirely in the production of final goods) because to do so would be to count them twice. For example, even though grain that a farmer produces may be that farmer's final product, it is not the final product for the nation. It is sold to make bread. Bread is the final product.

We can use a numerical example to clarify this point further. Our example will involve determining the value added at each stage of production. Value added is the amount of Rials value contributed to a product at each stage of its production. In Table 6-1, we see the difference between total value of all sales and value added in the production of a donut. We also see that the sum of the values added is equal to the sale price to the final consumer. It is the 4500 Rials that is used to measure GDP, not the 9600 Rials. If we used the 9600 Rials, we would be double counting from stages 2 through 5, for each intermediate good would be counted at least twice-one when it was produced and again when the good it was used in making was sold. Such double counting would grossly exaggerate GDP.

Table 6-1. Sales Value and Value Added at Each Stage of Donut Production

(1) Stage of Production	**(2) Rial Value of Sales**	**(3) Value Added**
Stage 1: Fertilizer and seed	300	300
Stage 2: Growing	600	300
Stage 3: Milling	1200	600
Stage 4: Baking	3000	1800
Stage 5: Retailing	4500	1500
	Total Rials value of all sales 9600 Rials	Total value added 4500 Rials

• Deriving GDP by the Expenditure Approach

To derive GDP using the expenditure approach, we must look at each of the separate components of expenditures and then add them together. These components are consumption expenditures, investment, government expenditures, and net exports.

Consumption Expenditures

How do we spend our income? As households or as individuals, we spend our income through consumption expenditure (C), which falls into three categories: durable consumer goods, nondurable consumer goods, and services. Durable goods are arbitrarily defined as items that last more than three years; they include automobiles, furniture, and household appliances. Nondurable goods are all the rest, such as food and gasoline. Services are intangible commodities: medical care, education, and the like.

Housing expenditures constitute a major proportion of anybody's annual expenditures. Rental payments on apartments are automatically included in consumption expenditures. People who own their homes, however, do not make rental payments. Consequently, government statisticians estimate what is called the implicit rental value of existing owner-occupied homes. It is roughly equal to the amount of rent you would have to pay if you did not own the home but were renting it from someone else.

Gross Private Domestic Investment

We now turn our attention to gross private domestic investment (I) undertaken by businesses. When economists refer to investment, they are referring to additions to productive capacity. Investment may be thought of as an activity that uses resources today in such a way that they allow for greater production in the future and hence greater consumption in the future. When a business buys new equipment or puts up a new factory, it is investing; it is increasing its capacity to produce in the future.

In estimating gross private domestic investment, government statisticians also add consumer expenditures on new residential structures because new housing represents an addition to our future productive capacity in the sense that a new house can generate housing services in the future.

The layperson's notion of investment often relates to the purchase of stocks and bonds. For our purpose, such transactions simply represent the transfer of ownership of assets called stocks and bonds. Thus, you must keep in mind the fact that in economics, investment refers only to additions to productive capacity, not to transfers of assets.

Fixed versus Inventory Investment

In our analysis, we will consider the basic components of investment. We have already mentioned the first one, which involves a firm's buying equipment or putting up a new factory. These are called producer durables, or capital goods. A producer durable, or a capital good, is simply a good that is purchased not to be consumed in its current form but to be used to make other goods and services. The purchase of equipment and factories-capital goods-is called fixed investment.

The other type of investment has to do with the change in inventories of raw materials and finished goods. Firms do not immediately sell off all their products to consumers. Some of this final product is usually held in inventory waiting to be sold. Firms hold inventories to meet future expected orders for their products. When a firm increases its inventories of finished products, it is engaging in inventory investment. Inventories consist of all finished goods on hand, goods in process, and raw materials.

The reason that we can think of a change in inventories as being a type of investment is that an increase in such inventories provides for future increased consumption possibilities. When inventory investment is zero, the firm is neither adding to nor subtracting from the total stock of goods or raw materials on hand. Thus, if the firm keeps the same amount of inventories throughout the year, inventory investment has been zero.

Government Expenditures

In addition to personal consumption expenditures, there are government purchases of goods and services (G). The government buys goods and services from private firms and pays wages and salaries to government employees. Generally, we value goods and services at the prices at which they are sold. But many government goods and services are not sold in the market. Therefore, we cannot use their market value when computing GDP. The value of these goods is considered equal to their cost. For example, the value of a newly built road is considered equal to its construction cost and is included in the GDP for the year it was built.

Net Exports (Foreign Expenditures)

To get an accurate representation of gross domestic product, we must include the foreign sector. As Iran residents, we purchase foreign goods called imports. The goods that foreign residents purchase from us are our exports. To determine the net expenditures from the foreign sector, we subtract the value of imports from the value of exports to get net exports (X) for a year:

$$\text{Net export (X)} = \text{total exports} - \text{total imports}$$

To understand why we subtract imports rather than ignoring them altogether, recall that we want to estimate domestic output. So we have to subtract Iran expenditures on the goods produced in other nations.

We have just defined the components of GDP using the expenditure approach. When we add them all together, we get a definition for GDP, which is as follows:

$$GDP = C + I + G + X$$

where

C = consumption expenditures
I = investment expenditures
G = government expenditures
X = net exports

Vocabulary and Comprehension Exercise

Exercises 6.2

Fill in the blanks with appropriate words from the following list.

factor	durables	expenditure	final
nondurables	inventories	Gross domestic product	
profit	services	income	market
value added	capacity		

1. In the circular flow model of income and output, households sell …………. services to businesses that pay for those services.

2. The receipt of payment is total ………… . Businesses sell goods and services to households that pay for them.

3. The Rial value of output is equal to the total monetary value of all ………….. goods and services produced.

4. The Rial value of final output must always equal total income; the variable that adjusts to make this so is known as …………....

5. In account of text, ………………… is the total market value of final goods and services produced in an economy during a one-year period by factors of production within the nation's borders.

6. To avoid double counting, we look only at final goods and services produced or, equivalently at …………… .

7. The ………. approach to measuring GDP requires that we add up consumption expenditures, gross private investment, government purchases, and net exports.

8. Consumption expenditure include consumer ……….., consumer ……….., and ………… .

9. Gross private domestic investment excludes transfer of asset ownership. It includes only additions to the productive ………….. of a nation, repairs on existing capital goods, and changes in business ………… .

10. We value government expenditures at their cost because we usually do not have ………. price at which to value government goods and services.

Comprehension Exercises

Exercise 6.3

1. What would be a total income?

a. The total of all individuals' income
b. The total of all businesses' income
c. The annual cost of producing the entire output of final goods and services.
d. a and c

2. In the factor market, …..

a. households are the sellers
b. businesses are buyers
c. businesses are sellers
d. a and b

3. Which one does not get included in measure of GDP?

a. final goods
b. intermediate services
c. final services
d. none of the above

4. In account of text, ……… is any use of today's resources to expand tomorrow's production or consumption.

a. Gross private domestic investment
b. Investment
c. Capital goods
d. Fixed investment

5. In account of text, ……….. is changes in the stocks of finished goods and goods in process, as well as changes in the raw materials that businesses keep on hand.

a. Inventory investment

b. Investment
c. Capital goods
d. Fixed investment

6. In account of text, ………… are consumer goods that have a life span of more than three years.
a. services
b. nondurable consumer goods
c. durable consumer goods
d. final goods

Exercise 6.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. ………. Businesses receive their income by selling the use of whatever factors of production they own, such as labor services.

2. ………. Business receipts are the opposite side of household expenditures.

3. ………. Transactions in which households buy goods take place in the factor markets-that’s where households are the buyers and businesses are the sellers of consumer goods.

4. ………. We therefore formally define GDP as the total market value of all final goods and services produced in an economy during a year.

5. ………. Bread is the final product.

6. ………. A producer durable, or a capital good, is simply a good that is purchased not to be consumed in its current form but to be used to make other goods and services.

7. ……… The value of a newly built road is considered equal to its construction cost and is included in the GDP for the year it was built.

Exercise 6.5

After reading the text, try to provide full answers to the following questions.

1. Explain the difference between product and factor market.
2. Describe the gross domestic product (GDP).
3. Why GDP does not count intermediate goods?
4. Summarize the GDP by expenditure approach in a single formula.
5. Cite the consumption expenditure categories.
6. Describe a producer durable, or a capital good.

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Exclusion of Final Transactions, Transfer Payments, and Secondhand Goods from GDP Estimation

Remember that GDP is the measure of the Rials value of all final goods and services produced in one year. Many more transactions occur that have nothing to do with final goods and services produced. There are financial transactions, transfers of the ownership of preexisting goods, and other transactions that should not and do not get included in our measure of GDP.

- **Financial Transactions**

There are three general categories of purely financial transactions: (1) the buying and selling of securities, (2) government transfer payments, and (3) private transfer payments.

Securities. When you purchase shares of existing stock in Microsoft Corporation, someone else has sold it to you. In essence, there was merely a transfer of ownership rights. You paid 1000000 Rials to obtain the stock. Someone else received the 1000000 Rials and gave up the stock. No producing activity was consummated at that time, unless a broker received a fee for performing the transaction, in which case only the fee is part of GDP. The 1000000 Rials transaction is not included when we measure GDP.

Government transfer payments. Transfer payments are payments for which no productive services are concurrently provided in exchange. The most obvious government transfer payments are Social Security benefits, veterans' payments, and unemployment compensation. The recipients make no contribution to current production in return for such transfer payments (although they may have contributed in the past to be eligible to receive them). Government transfer payments are not included in GDP.

Private transfer payments. Are you receiving funds from your parents in order to attend school? Has a wealthy relative ever given you a gift of cash? If so, you have been the recipient of a private transfer payment. This is merely a transfer of funds from one individual to another. As such, it does not constitute productive activity and is not include in GDP.

• Transfer of Secondhand Goods

If I sell you my two-year-old laptop computer, no current production is involved. I transfer to you the ownership of a computer that was produced years ago; in exchange, you transfer to me 3500000 Rials. The original purchase price of the computer was included in GDP in the year I purchased it. To include the price again when I sell it to you would be counting the value of the computer a second time.

• Other Excluded Transactions

Many of other transactions are not included in GDP for practical reasons:

- Household production-housecleaning, child care, and other tasks performed by people in their own households and for which they are not paid through the marketplace

- Otherwise legal underground transactions-those that are legal but not reported and hence not taxed, such as paying housekeepers in cash that is not declared as income
- Illegal underground activities-these include illegal gambling, and the sale of illicit drugs

Keywords

Business	داد و ستد، کسب و کار	Output	ستاده، محصول
Circular flow	جریان دایره‌ای	Ownership	مالکیت
Contribution	سهم	Rent	کرایه
Entrepreneur	مدیر یک بنگاه اقتصادی	Saving	پس‌انداز
Exports	صادرات	Secondhand Good	کالای دست دوم
Fund	وجه، موجودی دارایی	Securities	اوراق بهادار
Gross domestic product	تولید ناخالص داخلی	Stock	موجودی، سهام
Imports	واردات	Transaction	معامله، داد و ستد
Intermediate good	کالای واسطه‌ای	Value added	ارزش افزوده
Inventory	موجودی انبار	Wage	دستمزد
Investment	سرمایه‌گذاری		

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 6-1

1. g	2. h	3. j	4. f
5. i	6. k	7. l	8. c
9. b	10. e		

Exercise 6-2

1. factor	2. income	3. final	4. profit
5. Gross domestic product		6. value added	7. expenditure
8. durables, nondurables, services		9. capacity	10. market

Exercise 6-3

1. d	2. d	3. b	4. b
5. a	6. c		

Exercise 6-4

1. F	2.T	3. F	4. T
5. T	6. T	7. T	

Exercise 6-5

1. In product market households are the buyers and businesses are the sellers of consumer goods but in factor market households are the sellers and businesses are the buyers of resources such as labor, land, capital, and entrepreneurial ability.

2. GDP is the total market value of all final goods and services produced during a year by factors of production located within a nation's borders.

3. GDP does not count intermediate goods (goods used up entirely in the production of final goods) because to do so would be to count them twice. For example, even though grain that a farmer produces may be that farmer's final product, it is not the final product for the nation. It is sold to make bread. Bread is the final product.

4.

$$GDP = C + I + G + X$$

where

C = consumption expenditures
I = investment expenditures
G = government expenditures
X = net exports

5. As households or as individuals, we spend our income through consumption expenditure, which falls into three categories: durable consumer goods, nondurable consumer goods, and services.

6. A producer durable, or a capital good is a durable good having an expected service life more than three years that is used by businesses to produce other goods and services. Hence, a producer durable, or a capital good, is simply a good that is purchased not to be consumed in its current form but to be used to make other goods and services.

Chapter 7

Money and Banking

General Objectives

This unit has been designed to help you to:

- Define the fundamental functions of money.
- Identify key properties that functions as money.
- Explain the transactions approach to measuring money.
- Understand why financial intermediaries such as banks exist.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

ASSETS **n**

Amounts owned; all items to which a business or household holds legal claim.

Most individuals hold at least a part of their wealth in the form of the most liquid of **assets**, money.

ASYMMETRIC INFORMATION n

Information possessed by one party in a financial transaction but not by the other party.

One important reason that might people wish to direct their funds through a bank instead of lending them directly to a business is **asymmetric information**.

BARTER n

The direct exchange of goods and services for other goods and services without the use of money.

Before money was used, transactions took place by means of **barter**.

CENTRAL BANK n

A banker's bank, usually an official institution that also serves as a country's treasury's bank.

Central banks normally regulate commercial banks.

FIDUCIARY MONETARY SYSTEM n

A system in which money is issued by the government and its value is based uniquely on the public's faith that the currency represents command over goods and services.

In our **fiduciary monetary system**, there is not legal requirement for money, in the form of currency or transactions deposits.

FINANCIAL INTERMEDIARIES n

Institutions that transfer funds between ultimate lenders (savers) and ultimate borrowers.

Banks and savings institutions are **financial intermediaries**.

LIABILITIES n

Amounts owed; the legal claims against a business or household by nonowners.

Every financial intermediary has its own sources of funds, which are **liabilities** of that institution.

LIQUIDITY n

The degree to which an asset can be acquired of disposed of without much danger of any intervening loss in nominal value and with small transaction costs.

Money's attribute as the most readily tradable asset is called **liquidity**.

LOAN n

Sum of money that you borrow, usually from a bank or government, and have to pay back in smaller amounts with interest every week, month, or year.

They found it is impossible to get a bank **loan**.

MONEY **n**

Any medium that is universally accepted in an economy both by sellers of goods and services as payment for those goods and services and by creditors as payment for debts.

One of the **money** functions that most people are familiar with is **money**'s function as a medium of exchange.

MORAL HAZARD **n**

The possibility that a borrower might engage in riskier behavior after a loan has been obtained.

Adverse selection and **moral hazard** both explain why people use financial intermediaries.

THRIFT INSTITUTIONS **n**

Financial institutions that receive most of their funds from the savings of the public.

Thrift institutions include savings banks, savings and loan associations, and credit unions.

TRANSACTIONS DEPOSITS **n**

Checkable and debitable account balances in commercial banks and other types of financial institutions, such as credits unions and savings banks.

You can easily transmit debit-card and check payments without many restrictions from **transaction deposits**.

TRAVELER'S CHECKS **n**

Financial instruments obtained from a bank or a nonbanking organization and signed during purchase that can be used as cash upon a second signature by the purchaser.

The total quantity of **traveler's checks** outstanding issued by institutions other than banks is part of the transaction approach to measuring money supply.

UNIT OF ACCOUNTING **n**

A measure by which prices are expressed; the common denominator of the price system; a central property of money.

Rial is the **unit of accounting** in Iran.

Vocabulary

Exercises 7.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. Banking	a. lending
2. barter	b. saving account
3. currency	c. business
4. liability	d. export
5. loan	e. having enough cash
6. thrift	f. business activity of banks
7. transaction	g. economizing
8. deposit	h. debt
9. financial	i. cash
10. liquidity	j. trade
	k. monetary
	l. fiscal

Money and Banking

- **The Functions of Money**

Money traditionally has four functions. The one that most people are familiar with is money's function as a medium of exchange. Money also serves as a unit of accounting, a store of value or purchasing power, and a standard of deferred payment. Anything that serves these four functions is money. Anything that could serve these four functions could be considered money.

Money as a Medium of Exchange

When we say that money serves as a medium of exchange, we mean that sellers will accept it as payment in market transactions. Without some generally accepted medium of exchange, we would have to resort to barter. In fact, before money was used, transactions took place by means of barter. Barter is simply a direct exchange of goods for goods. In a barter economy, the shoemaker who wants to obtain a dozen water glasses must seek out a glassmaker who at exactly the same time is interested in obtaining a pair of shoes. For this to occur, there has to be a high likelihood of a double coincidence of wants for each specific item to be exchanged. If there isn’t, the shoemaker must go through several trades in order to obtain the desired dozen glasses-perhaps first trading shoes for jewelry, then jewelry for some pots and pans, and then the pots and pans for the desired glasses.

Money facilitates exchange by reducing the transaction costs associated with means-of-payment uncertainty. That is, the existence of money means that individuals no longer have to hold a diverse collection of goods as an exchange inventory. As a medium of exchange, money allows individuals to specialize in producing those goods for which they have a comparative advantage and to receive money payments for their labor. Money payments can then be exchanged for the fruits of other people’s labor. The use of money as a medium of exchange permits more specialization and the inherent economic efficiencies that come with it (and hence greater economic growth).

Money as a Unit of Accounting

A unit of accounting is a way of placing a specific price on economic goods and services. It is the common denominator, the commonly recognized measure of value. Rial is the unit of accounting in Iran. It is the yardstick that allows individuals easily to compare the relative value of goods and services. Accountants in Iran's department of commerce use Rial prices to measure national income and domestic product, a business uses Rial prices to calculate profits and losses, and a typical household budgets regularly anticipated expenses using Rial prices as its unit of accounting.

Another way of describing money as a unit of accounting is to say that it serves as a standard of value that allows people to compare the relative worth of various goods and services. This allows for comparison shopping, for example.

Money as a Store of Value

One of the most important functions of money is that it serves as a store of value or purchasing power. The money you have today can be set aside to purchase things later on. In the meantime, money retains its nominal value, which you can apply to those future purchases. If you have 1000000 Rials in your checking account, you can choose to spend it today on goods and services, spend it tomorrow, or spend it a month from now. In this way, money provides a way to transfer value (wealth) into the future.

Money as a Standard of Deferred Payment

The fourth function of the monetary unit is as a standard of deferred payment. This function involves the use of money both as a medium of exchange and as a unit of accounting. Debts are typically stated in terms of a unit of accounting; they are paid with a monetary medium of exchange. That is to say, a debt is specified in a Rial amount and paid in currency (or by check). A corporate bond, for example, has a face value-the Rial value stated on it, which is to be paid upon maturity. The periodic interest payments on that corporate bond are specified and paid in Rials, and when the bond comes due (at maturity), the corporation pays the face value in Rials to the holder of the bond.

- **Properties of Money**

Money is an asset-something of value-that accounts for part of personal wealth. Wealth in the form of money can be exchanged later for other assets, goods, or services. Although money is not the only form of wealth that can be exchanged for goods and services, it is the most widely and readily accepted one.

Money-The Most Liquid Asset

Money's attribute as the most readily tradable asset is called liquidity. We say that an asset is liquid when it can easily be acquired or disposed of without high transaction costs and with relative certainty as to its value. Money is, by definition, the most liquid asset. People can easily convert money to other asset forms. Therefore, most individuals hold at least a part of their wealth in the form of the most liquid of assets, money. When we hold money, however, we incur a cost for this advantage of liquidity. Because cash in your pocket and many checking or debit account balances do not earn interest, that cost is the interest yield that could have been obtained had the asset been held in another form-for example, in the form of stocks and bonds.
The cost of holding money (its opportunity cost) is measured by the alternative interest yield obtained by holding some other assets.

Monetary Standards, or What Backs Money

In the past, many different monetary standards have existed. For example, commodity money, which is a physical good that may be valued for other uses it provides, has been used. The main forms of commodity money were gold and silver. Today, though most people throughout the world accept coins, paper currency, and balances held on deposit as transactions deposits (debitable and checkable accounts with banks and other financial institutions) in exchange for items sold, including labor services. But these forms of money raise a question: Why are we willing to accept as payment something that has no intrinsic value? After all, you could not sell checks or debit cards to many producers for use as a raw material in manufacturing. The reason is that payments in the modern world arise from a fiduciary monetary system. This means that the value of the payments rests on the public's confidence that such payments can be exchanged for goods and services. Fiduciary comes from the Latin fiducia, which means "trust" or "confidence". In our fiduciary monetary system, there is not legal requirement for money, in the form of currency or transactions deposits, to be convertible to a fixed quantity to gold, silver, or some other precious commodity. The bills are just pieces of paper. Usually, coins have a value stamped on them that today is greater than the market value of the metal in them. Nevertheless, currency and transactions deposits are money because of their acceptability and predictability of value.

Acceptability

Transactions deposits and currency are money because they are accepted in exchange for goods and services. They are accepted because people have confidence that these items can later be exchanged for other goods and services. This confidence is based on the knowledge that such exchanges have occurred in the past without problems.

Predictability of Value

Money retains its usefulness even if its purchasing power is declining year in and year out, as in periods of inflation, if still retains the characteristic of predictability of value. If you anticipate that the inflation rate is going to be around 3 percent during the next year, you know that any Rial you receive a year from now will have a purchasing power equal to 3 percent less than that same Rial today. Thus, you will not necessarily refuse to accept money in exchange simply because you know that its value will decline by the rate of inflation during the next year. You may, however, wish to be compensated for that expected decline in money's real value.

- **Defining Money**

Money is important. Changes in the total money supply-the amount of money in circulation-and changes in the rate at which the money supply increases or decreases affect important economic variables, such as the rate of inflation, interest rates, and (at least in the short run) employment and the level of real GDP. Although there is widespread agreement among economists that money is indeed important, they have struggled to reach agreement about how to define and measure it. There are two basic approaches: the transactions approach, which stresses the role of money as a medium of exchange, and the liquidity approach, which stresses on the role of money as a temporary store of value.

The Transactions Approach to Measuring Money: M1

Using the transactions approach to measuring money, the money supply consists of currency, transactions deposits, and traveler's checks non issued by banks. One key designation of the money supply, including currency, transactions deposits, and traveler's checks not issued by banks, is M1.

Currency

The largest component of Iran currency is paper bills. Iran currency also consists of coins minted by the Iran treasury. Central Bank issues paper notes and coins throughout the Iran banking system.

Transactions Deposits

Individuals conduct most of their larger transactions with debit cards and checks. The convenience and safety of using debit cards and checks have made transactions deposits the most important component of the money supply. Debit and checking transactions are a means of transferring the ownership of deposits in financial institutions. Hence, transactions deposits are normally acceptable as a medium of exchange. The financial institutions that offer transactions deposits are numerous and include commercial banks and virtually all thrift institutions saving banks, saving and loan associations, and credit unions.

Traveler's Checks

Traveler's checks are paid for by the purchaser at the time of transfer. The total quantity of traveler's checks outstanding issued by institutions other than banks is part of the M1 money supply.

Vocabulary and Comprehension Exercise

Exercises 7.2

Fill in the blanks with appropriate words from the following list.

standard of deferred payment		fiduciary	M1
money supply	liquid	barter	unit of accounting
transactions	central bank	predictable	money
transaction deposits			

1. Any medium that is universally accepted in an economy both by sellers of goods and services as payment for those goods and services and by creditors as payment for debts is called ……..
2. Money is defined by its function, which are as a medium of exchange, ………….., store of value, and …………..
3. An official institution that serves as a country's treasury's bank is called ……………
4. Money is a highly ………… asset because it can be disposed of with low transaction costs and with relative certainty as to its value.
5. The amount of money in circulation is called ……….

6. Modern nations have ………… monetary systems national currencies are not convertible into a fixed quantity of a commodity such as gold or silver.
7. Any deposits in financial institutions from which the deposit owner can transfer funds using a debit card or checks are called ………..
8. Money is accepted in exchange for goods and services because people have confidence that it can later be exchanged for other goods and services. In addition, money has ………… value.
9. Using the …………. approach, the money supply consists of currency, transactions deposits, and traveler's checks. This is called ………….
10. The direct exchange of goods and services for other goods and services without the use of money is called ………..

Comprehension Exercises

Exercise 7.3

1. Which function of money does mean that "sellers will accept money as payment in market transactions"?
   a. medium of exchange
   b. unit of accounting
   c. store of value
   d. standard of deferred payment
2. Which function of money does mean that "money serves as a standard of value that allows people to compare the relative worth of various goods and services"?
   a. medium of exchange
   b. unit of accounting
   c. store of value
   d. standard of deferred payment
3. Which one is one of the most important function of money?
   a. medium of exchange
   b. unit of accounting

c. store of value
d. standard of deferred payment

4. Why people can easily convert money to other asset forms?
a. Because money is medium of exchange
b. Because money is unit of accounting
c. Because money is store of value
d. Because money is the most liquid asset

5. Which one is the largest component of Iran currency?
a. Coins minted by the Iran treasury
b. Paper bills
c. Central Bank issue paper notes
d. Coins throughout the Iran banking system

6. Which one is included in transactions approach to measuring money?
a. Currency
b. Transactions deposits
c. Traveler's checks non issued by banks
d. All of the above

Exercise 7.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. ……. Before money was used, transactions took place by means of barter.

2. ……. When we hold money, however, we incur a profit for this advantage of liquidity.

3. ……. Usually, coins have a value stamped on them that today is less than the market value of the metal in them.

4. ……. The convenience and safety of using debit cards and checks have made transactions deposits the most important component of the money supply.

5. …….. Currency and transactions deposits are money because of their acceptability and predictability of value.
6. ……… Money as a standard of deferred payment serves as a standard of value that allows people to compare the relative worth of various goods and services.
7. ……… Asset is liquid when it can easily be acquired or disposed of without high transaction costs and with relative certainty as to its value

Exercise 7.5

After reading the text, try to provide full answers to the following questions.

1. What are the fundamental functions of money?
2. Why currency and transactions are deposits money?
3. Explain the properties of money. Why is money the most liquid asset?
4. Describe the transactions approach to measuring money.
5. What is the fiduciary monetary system?
6. What is the cost of holding money?

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Financial Intermediation and Banks

Most nations, including Iran, have a banking system that encompasses two types of institutions. One type consists of private banking institutions. These include commercial banks, which are privately owned profit-seeking institutions, and thrift institutions, such as saving banks, saving and loan associations, and credit unions. Thrift institutions may be profit-seeking institutions, or they may be mutual institutions that are owned by their depositors. The other type of institution is a central bank, which typically serves as a banker's bank.

Direct versus Indirect Financing

When individuals choose to hold some of their savings in new bonds issued by a corporation, their purchases of the bonds are in effect direct loans to the business. This is an example of direct finance, in which people lend funds directly to a business. Business financing is not always direct. Individuals might choose instead to hold a time deposit at a bank. The bank may then lend to the same company. In this way, the same people can provide indirect finance to a business. The bank makes this possible by intermediating the financing of the company.

Financial Intermediation

Banks and other financial institutions are all in the same business-transferring funds from savers to investors. This process is known as financial intermediation, and its participants, such as banks and savings institutions, are financial intermediaries.

Asymmetric Information, Adverse Selection, and Moral Hazard

Why might people wish to direct their funds through a bank instead of lending them directly to a business? One important reason is asymmetric information-the fact that the business may have better knowledge of its own current and future prospects than potential lenders do. For instance, the business may know that it intends to use borrowed funds for projects with a high risk of failure that would make repaying the loan difficult. This potential for borrowers to use the borrowed funds in high-risk projects is known as adverse selection. Alternatively, a business that had intended to undertake low-risk projects may change management after receiving a loan, and the new managers may use the borrowed funds in riskier ways. The possibility that a borrower might engage in behavior that increases risk after borrowing funds is called moral hazard.

To minimize the possibility that a business might fail to repay a loan, people thinking about lending funds directly to the business must study the business carefully before making the loan, and they must continue to monitor its performance afterward. Alternatively, they can choose to avoid the trouble by holding deposits with financial intermediaries, which then specialize in evaluating the creditworthiness of business borrowers and in keeping tabs on their progress until loans are paid. Thus, adverse selection and moral hazard both explain why people use financial intermediaries.

Larger Scale and Lower Management Costs

Another important reason that financial intermediaries exist is that they make it possible for many people to pool their funds, thereby increasing the size, or scale, of the total amount of savings managed by an intermediary. This centralization of management reduces costs and risks below the levels savers would incur if all were to manage their savings alone. Pension fund companies, which are institutions that specialize in managing funds that individuals save for retirement, owe their existence largely to their abilities to provide such cost savings to individual savers. Likewise, investment companies, which are institutions that manage portfolios of financial instruments called mutual funds on behalf of shareholders, also exist largely because of cost savings from their greater scale of operations.

Financial Institution Liabilities and Assets

Every financial intermediary has its own sources of funds, which are liabilities of that institution. When you place 1000000 Rials in your transactions deposit at a bank, the bank creates a liability-it owes you 1000000 Rials-in exchange for the funds deposited. A commercial bank gets its funds from transactions and savings accounts; an insurance company gets its funds from insurance policy premiums. Each financial intermediary has a different primary use of its assets. For example, a credit union usually makes small consumer loans, whereas a savings bank makes mainly mortgage loans.

Keywords

Accounting	حسابداری	Hazard	ریسک، خطر
Asset	دارایی	Intermediary	واسطه
Asymmetric	نامتناسب	Liabilities	بدهی
Barter	مبادله پایاپای	Liquidity	نقدینگی
Bill	اسکناس	Loan	وام
Coin	سکه	Medium	واسطه
Currency	پول در گردش	Predictability	قابلیت پیش‌بینی
Deferred payment	پرداخت معوق، پرداخت آتی	Store	ذخیره
Deposit	سپرده	Thrift institutions	مؤسسات پس‌انداز
Fiduciary	معتبر		

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 7-1

1. f	2. c	3. i	4. h
5. a	6. g	7. j	8. b
9. l	10. e		

Exercise 7-2

1. money
2. unit of accounting, standard of deferred payment
3. central bank
4. liquid
5. money supply
6. fiduciary
7. transaction deposits
8. predictable
9. transactions, M1
10. barter

Exercise 7-3

1. a	2. b	3. c	4. d
5. b	6. d		

Exercise 7-4

1. T	2. F	3. F	4. T
5. T	6. F	7. T	

Exercise 7-5

1. Money traditionally has four functions. Medium of exchange, unit of accounting, store of value or purchasing power, and standard of deferred payment.

2. Currency and transactions deposits are money because of their acceptability and predictability of value.

3. The most liquid asset, acceptability, and predictability of value are the money properties. Money is by definition the most liquid asset because people can easily convert money to other asset forms.

4. Using the transactions approach to measuring money, the money supply consists of currency, transactions deposits, and traveler's checks non issued by banks.

5. Fiduciary monetary system is a system in which money is issued by the government and its value is based uniquely on the public's faith that the currency represents command over goods and services.

6. The cost of holding money (its opportunity cost) is measured by the alternative interest yield obtained by holding some other asset.

Chapter 8

Accounting Statements

General Objectives

This unit has been designed to help you to:

- Explain the income statement.
- Identify the owner's equity statement.
- Understand the balance sheet statement.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

ASSETS **n**

Amounts owned; all items to which a business or household holds legal claim.

The balance sheet is listing of **assets**, liabilities, and owner's equity at a point in time.

BALANCE SHEET **n**

A written statement of the amount of money and property a company has, the amount of money it is owed, and the amount of money it owes to other people.

The figures show a deficit of 56 million rials in the **balance sheet** for 2009.

CAPITAL **n**

Large sum of money used in a business or invested to make more money.

Most Hungarian companies desperately lack **capital**.

EXPENSE **n**

Money that something costs or that you need to pay for something.

People won't be left with enough to pay for basic everyday **expenses**.

FEE **n**

Sum of money that you pay to be allowed to do something.

They spend the afternoons looking at the pictures outside cinemas, unable to afford the entrance **fee**.

INCUR **v**

Something happens to you because of what you do.

Business expenses has **incurred** outside the office.

INTEREST **n**

Extra money that you receive if you have invested a sum of money, or money that you pay if you have borrowed money.

The **interest** you pay on your mortgage is very high.

INVEST **v**

Pay money into a bank or buy something such as shares or property with it, because you think that you will be able to earn more money from it.

Much of the money was **invested** in property.

OWNER **n**

The person to whom something belongs.

Shop owners are refusing credit cards and cheques.

PROPRIETORSHIP **n**

A business owned by one individual who makes the business decisions, receives all the profits, and is legally responsible for the debts of the firm.

He refused to accept the **proprietorship** of the newspaper.

RENT **n**

Amount of money that you pay regularly for the use of a house, flat, or piece of land.

He made enough money to pay the **rent**.

REVENUE **n**

The money that a government or organization receives from people.

A recession would reduce government tax **revenues**.

SALARY **n**

The money that someone is paid for his job each month, especially when he has a professional job.

There is a difference in **salary** between an instructor and a lecturer.

STATEMENT **n**

An official or formal announcement that has been specially prepared for a particular occasion or situation.

Computerized bank **statements** are always correct.

SUPPLIES **n**

Something needed by a group of people, for example by an army or people going on an expedition.

Residents are boarding up their homes and stocking up on emergency **supplies**.

UTILITY EXPENSES **n**

The expenses of an important service such as water, electricity, or gas that is provided for everyone.

The **utility expenses** are elementary expenses which every company must provide.

VENDOR **n**

Someone who sells things such as newspapers, cigarettes, or hamburgers from a small stall or cart.

Cigarette vendors are very poor.

WITHDRAWAL **n**

An amount of money that you take from your bank account.

It is not the bank's policy to deduct interest on **withdrawals**.

Vocabulary

Exercises 8.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. net loss	a. cash or other assets removed from a business entity by the owner
2. withdrawal	b. the financial statement that lists the assets owned, liabilities owed, and owner's equity at a specific point in time
3. profit	c. The economic resources consumed in providing products or services to customers
4. balance sheet	d. the excess of expenses over revenues
5. net income	e. the excess of revenues over expenses
6. expenses	f. the inflow of economic resources for goods sold, or services rendered
7. capital	g. price
8. revenue	h. the excess of revenues over expenses; also called profit
9. vendor	i. income
10. fee	j. seller
	k. consumer
	l. a term often used in accounting to mean owner's equity

The principal financial statements

Accounting is often referred to as the "language of business". It is a process whose goals are the recording, summarizing, classifying, and reporting of financial information. The inputs to this process are the transactions that a company engages in; the output is the financial statements. The financial statements of a sole proprietorship or partnership consist of the balance sheet, the income statement, the capital statement, and the statement of cash flows. The principal financial statements are the income statement, the statement of owner's equity, and the balance sheet.

• The income statement

The financial statement that reports the profitability of a business entity is the income statement. Many business people consider the income statement more important than the statement of owner's equity or the balance sheet because the first question asked by most users is, Did the business earn a profit? The answer to that question can be found on an income statement. The income statement compares revenue earned during a specified period of time with expenses incurred during that same period of time, as seen in the following income statement for a proprietorship:

Table 8-1. Victor's Research Lab Income Statement

Victor's Research Lab Income Statement Year Ended December 31, 2009		
Revenues:		
Laboratory Fees		$ 172300
Expenses:		
Salaries Expense	$ 76300	
Rent Expense	$ 15700	
Supplies Expense	$ 10800	
Utilities Expense	$ 7500	
Total Expense		$ 110300
Net Income		$ 62000

Revenue

The amount charged for goods sold or services rendered is called revenue. Revenue represents the inflow of economic resources to a business entity. Examples of revenues are sales, commissions earned, rental fees, and fees for professional services performed.

Total revenue earned by Victor's Research Lab for the year ended December 31, 2009 is $172300. This revenue resulted from the performance of laboratory analysis services, shown as Laboratory Fees of $172300. These fees are counted revenue when the laboratory services are performed.

Expenses

A business' expenses represent the economic resources consumed in providing products or services to customers. Expenses include the cost of goods sold or services rendered to generate revenue- such as the cost of the supplies Victor's Research Lab uses and the technicians in hires to do the analyses. Expenses also include the cost of goods or services the company buys to operate the business- such as salaries of employees, delivery costs, repairs, laboratory supplies, advertising costs, rent, cleaning services, travel expenses, and so on. Victor's Research Lab incurred $110300 of expenses.

The financial statements for Victor's Research Lab are prepared using the accrual basis of accounting. This means, as we noted above, that revenue is received. It also means that expenses are considered incurred when services are received, not when cash is paid. Recording revenues only when cash is received and recording expenses only when cash is paid is called the cash basis of accounting.

Many small businesses use the cash basis of accounting because it is much easier than the accrual basis of accounting. However, when a business has significant transactions involving extending credit to customers, or receiving credit from vendors, and acquiring goods for resale, generally accepted accounting principles require the use of the accrual method.

When a business has more revenue than expenses, the difference is its profit, also called net income. For the year just ended, Victor's Research Lab's revenue exceeds its expenses by $62000, which is

Victor's net income. When expenses exceed revenue, the difference is called net loss and the business has been unprofitable.

The Heading

Notice that the income statement is identified by a heading and that the heading consists of three lines:

Line 1: The name of the company

Line 2: The type of financial statement

Line 3: The period of time covered by the financial statement

The last item is very important. Revenue and expenses are time concepts. Revenue is earned and expenses are incurred over a period of time. Common sense tells us that a net income of $62000 for the year is quite different from a net income of $62000 for the month. When we say that Victor's Research Laboratory had revenue of $15000 in January, you will know that we mean Victor's Research Laboratory has sold goods or services amounting to $15000 from Jan. 1 to Jan. 31. If we say that the laboratory incurred $10000 of expenses in the second quarter, you will know that this amount was incurred from Apr. 1 to June 30. And if we say that the laboratory had revenue of $172300 for the year, you will know that the amount of revenue earned from Jan. 1 to Dec. 31. Without knowing what period of time the statement covers, users cannot interpret the financial data reported, nor can they compare them with previous financial statements or financial statements of other firms.

• The statement of owner's equity

The statement of owner's equity shows how the owner's investment has changed from the start of a period to the end of a period. It is a connecting link between the income statement and the balance sheet. For Victor's Research Lab the statement of owner's equity looks like this.

Table 8-2. Victor's Research Lab Statement of Owner's Equity

Victor's Research Lab Statement of Owner's Equity Year Ended December 31, 2009	
Victor, Capital, Jan. 1, 2009	$ 91000
Add: Net Income	$ 62200
Total	$ 153200
Less: Withdrawals	(50000)
Victor, Capital, Dec. 31, 2009	$ 103200

Again, as with income statement, the heading is important. It has three parts:

Line 1: The name of the company

Line 2: The type of financial statement

Line 3: The period of time covered by the financial statement

This statement is like the income statement in that it too covers a period of time, form Jan. 1, 2009, to Dec. 31, 2009. The statement tells us that Victor started the year with $91000 of equity, or capital invested in his firm. Victor's investment is shown as Victor, Capital. During the year he increased his capital by $62200, the net income we saw on the income statement. However, he took $50000 from the business for his personal use. This is shown as Withdrawals. He ended the year with capital of $103200. This is the amount that will appear on the December 31, 2009. Balance sheet discussed in the next section.

• The balance sheet

The financial statement designed to show a business entity's financial position-what it owns and what it owes-on a particular date is called the balance sheet.

Study the balance sheet for Victor's Research Laboratory shown in table 8-3. For the moment, don't be too concerned about the technical terms listed in it. Notice that the balance sheet consists of two sides. The left represents what the firm owns, its assets; the right side represents what the firm owes, its liabilities; and the amount of the owner's investment in the business, the owner's equity. In a sense, the business owes the amount shown under owner's equity to the owner. If the business were sold or dissolved and all the liabilities paid, the remaining money would be paid to the owner.

The total of the assets, $131100 on the left side of Victor's Research Lab balance sheet, must equal, or balance with, the sum of the liabilities, $27900, and the owner's equity, $103200, on the right side-hence the term balance sheet.

Like the income statement and the statement of owner's equity, the balance sheet has a heading with three important parts, as follows:

Line 1: The name of the company

Line 2: The type of financial statement

Line 3: The date of balance sheet

Unlike the income statement and statement of owner's equity, which cover a specified period of time, the balance sheet is listing of assets, liabilities, and owner's equity at a point in time. That point in time for Victor's Research Lab is the close of business on Dec. 31, 2009.

Table 8-3. Victor's Research Lab Balance Sheet

Victor's Research Lab Balance sheet Year Ended December 31, 2009			
Assets		**Liabilities and Owner's Equity**	
Cash	$ 8700	Liabilities:	
Accounts Receivable	15400	Notes Payable	$ 20000
Supplies on Hand	3200	Accounts Payable	7900
Land	21000	Total Liabilities	$ 27900
Building	55000		
Equipment	27800	Owner's Equity	
		Victor, Capital	103200
Total Assets	$131100	Total Liabilities and Owner's Equity	$ 131100

Assets

The assets of an economic entity are the economic resources that are owned by the entity and are expected to provide future benefits. Assets may be physical in nature, such as cash, merchandise, supplies, equipment, trucks, machines, buildings, and land.

Nonphysical assets can be legal claims, such as payments due from customers, called accounts receivable, or legal rights such as patents or copyrights. These nonphysical assets are expected to produce future benefits. For example, when we sell a product for $10 to one of our customers, the customer may not pay the amount due today. He or she may charge it, and pay at the end of the month. We have sold our product on account, earning revenue of $10, and we have a nonphysical asset-an account receivable of $10 which we anticipate will be collected shortly. The future benefit is the cash we will receive at the end of the month.

To be included on the balance sheet as an asset, an economic resource must be measurable; if it is not measurable, it is not an asset. For example, the managerial ability of the company's president is an economic resource that will provide future benefit, but it cannot be measure in dollars.

Liabilities

The liabilities of an economic entity are its debts. The debts may be represented as formal claims or informal claims. A formal claim is a written contract, such as a written promise to repay a borrowed sum of money at a specified future date; this is called a note payable. Or a debt may be represented as an informal claim such as an amount due to a creditor for goods and services acquired but not yet paid for, this is called an account payable.

Owner's Equity

To convey to you the meaning of owner's equity, an example is needed. Assume that you decide to go into business and invest $40000 of your own money to buy an empty factory building worth $30000 and the land it is located on, worth $10000. Next, you borrow $60000 from a bank and buy machines for $50000 to put in the factory, keeping $10000 on hand for expenses. That's it. You need nothing else; you are ready to operate. At this point you could prepare a balance sheet. If you did, it would look like this:

Table 8-4. Balance Sheet Example

Assets		Liabilities and Owner's Equity	
Assets:		Liabilities:	$60000
Cash	$10000		
Land	10000	Owner's Equity	40000
Building	30000		
Machines	50000		
Totals	$100000	Totals	$100000

The bank has a claim on your assets amounting to $60000. This is a liability. There are no other creditor's claim on your assets. The difference between the assets and the creditor's claim on those assets, the liabilities, represents your owner's interest in the business. Thus your $40000 interest in your business is your owner's equity, or capital. Since your creditor's claim on your assets takes precedence over yours, your owner's equity represents the difference between your assets and your liabilities.

Vocabulary and Comprehension Exercise

Exercises 8.2

Fill in the blanks with appropriate words from the following list.

investments	financial	balance sheet	account payable
liability	withdrawal	creditor	income statement
assets	owner's equity		

1. The owners, managers, and major creditors are anxious to see the latest available …………… and thereby to judge how well the company is doing.

2. The liability arising from the purchase of goods or services on credit is called an …………, and the person or company whom the account payable is owed is called a ……….

3. A ………….. shows the financial position of a business at a particular date.

4. A set of ……......... statements become easier to understand if we recognize how the income statement and balance sheet are related.

5. Economic resources which are owned by a business and are expected to benefit future operations are called …………

6. When a business borrows money for any reason, a …………. is incurred and the lender becomes a creditor of the business.

7. There are two ways in which the ……………... may be decreased: (1) …………. of assets by the owner, and (2) operating the business at a loss.

8. Owner's equity may be increased by …………….. of cash or other assets by the owner.

Comprehension Exercises

Exercise 8.3

1. The income statement reports:

a. business affairs at a particular date

b. business activities over a period of time

c. the financial position of a business over a period of time

d. financial activities at a particular date

2. expenses include:

a. the cost of a goods sold or services rendered to generate revenue

b. the cost of goods or services the company buys to operate the business

c. a and b

d. the salaries of employee, delivery cost, travel cost, and so on

3. expenses are incurred when:

a. services are rendered

b. goods or services are acquired or received

c. services are performed

d. payment is received

4. Which one does show how the owner's investment has changed from the start of a period to the end of a period?

a. Income statement
b. Statement of Owner’s equity
c. Balance sheet
d. Company’s revenues

5. Which one is the financial statement designed to show a business entity’s financial position-what it owns and what it owes-on a particular date?
a. Income statement
b. Statement of Owner’s equity
c. Balance sheet
d. Company’s revenues

6. Which one is an economic entity’s formal claim or informal claims?
a. Assets
b. Liabilities
c. Owner’s equity
d. Revenues

Exercise 8.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …… Like the income statement and statement of owner’s equity, the balance sheet covers a specified period of time.
2. ……The income statement, the statement of owner’s equity, and the balance sheet are the three principal financial statements.
3. …… The statement of owner’s equity is a connection link between the income statement and the balance sheet.
4. …….. Net income is the excess of expenses over revenues.
5. ……. The financial statement designed to report the profitability of a business entity, is named income statement.
6. …… The name of company is written on the second line of the heading.

7. …… The assets of a business entity will always equal to the difference between its liabilities and owner's equity.
8. …… Revenue can usually be equated to the amount of cash received by a business entity for a given period of time.
9. ……. The capital account is increased by investments from the owner and net income.
10. …… The left side of balance sheet represents what the firm owns.

Exercise 8.5

After reading the text, try to provide full answers to the following questions.

1. What is the purpose of income statement?
2. Write three examples of revenues.
3. What is the difference between the accrual basis of accounting, and the cash basis of accounting?
4. What does a statement of owner's equity show?
5. What is the role of withdrawals in a statement of owner's equity?
6. What does a balance sheet show?

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Financial Statements: The Starting Point in the Study of Accounting

The preparation of financial statements is not the first step in the accounting process, but it is a convenient point to begin the study of accounting. The financial statements are the means of conveying to management and to interested outsiders a concise picture of the profitability sense, the end product of the accounting process. The student who acquires a clear understanding of the content and meaning of financial statements will be in an excellent position to appreciate the purpose of the earlier steps of recording and classifying business transactions.

The two most widely used financial statements are the balance sheet and the income statement. Together, these two statements (perhaps a page each in length) summarize all the information contained in the hundreds or thousands of pages comprising the detailed accounting records of a business.

The balance sheet

The purpose of a balance sheet is to show the financial position of a business at a particular date. Every business prepares a balance sheet at the end of the year, and most companies prepare one at the end of each month. A balance sheet consists of a listing of the assets and liabilities of a business and of the owner's equity. The following balance sheet portrays the financial position of Vagabond Travel Agency at December 31, 2009.

Table 8-5. Vagabond's Travel Agency Balance Sheet

Vagabond's Travel Agency Balance sheet Year Ended December 31, 2009			
Assets		Liabilities and Owner's Equity	
Cash	$ 7500	Liabilities:	
Notes Receivable	8000	Notes Payable	$ 52000
Accounts Receivable	57000	Accounts Payable	15000
Supplies	1500	Salaries Payable	3000
Land	40000	Total Liabilities	$ 70000
Building	44000	Owner's Equity:	
Office Equipment	12000	Terry Crane, Capital	100000
Total	$170000	Total	$170000

Note that the balance sheet sets three in its heading three items: (1) the name of the business, (2) the name of the financial statement "Balance Sheet", and (3) the date of the balance sheet. Below the heading is the body of the balance sheet, which consists of three distinct sections: assets, liabilities, and owner's equity.

Another point to note about the form of a balance sheet is that cash is always the first asset listed; it is followed by notes receivable, accounts receivable, supplies, and any other assets that will soon be converted into cash or consumed in operations. Following these items are the more permanent assets, such as land, building, and equipment.

The liabilities of a business are always listed before the owner's equity. Each liability (such as notes payable, accounts payable, and salaries payable) should be listed separately, followed by total figure for liabilities.

Keywords

Accrual	تعهدی	Inflow	جریان ورودی
Balance sheet	ترازنامه	Investment	سرمایه‌گذاری
Business entity	واحد انتفاعی	Payable notes	اسناد پرداختی
Cash	نقدی	payable	پرداختی
Capital	سرمایه	Proprietorship	مالکیت انفرادی
Claim	ادعا	Receivable	دریافتی
Debt	بدهی	Revenue	درآمد
Due	طلب	Statement	صورت حساب
Equity	سرمایه، ارزش خالص دارایی	Owner's equity statement	صورت حقوق صاحبان سرمایه
Expense	هزینه		
Income statement	صورت سود و زیان	Withdrawal	برداشت

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 8-1

1. d	2. a	3. e	4. b
5. h	6. c	7. l	8. i
9. j	10. g		

Exercise 8-2

1. income statement
2. account payable, creditor
3. balance sheet
4. financial
5. assets
6. liability
7. owner's equity, withdrawal
8. investments

Exercise 8-3

1. c	2. c	3. b	4. b
5. c	6. b		

Exercise 8-4

1. F	2. T	3. T	4. F
5. T	6. F	7. F	8. F
9. T	10. T		

Exercise 8-5

1. The purpose of income statement is to report the profitability of a business entity.

2. Sales, commissions earned, and rental fees.

3. In accrual basis of accounting, the revenue is considered to be earned when services are performed, and the expenses are considered incurred when services are received. But in cash basis of accounting, revenue is recorded only when cash is received and expense is recorded only when cash is paid.

4. It shows how the owner's investment has changed from the start of a period to the end of a period.

5. It is a decreasing element of capital in a statement of owner's equity.

6. It shows the financial position of a business entity on a particular date.

Chapter 9

Generally Accepted Accounting Principles

General Objectives

This unit has been designed to help you to:

- Explain the cost principle.
- Identify the objectively principle.
- Discuss the business entity, going concern, and stable-rial concepts.
- Understand the basic accounting model.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words appeared in the text.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the exercises.

Vocabulary Help

ACCOUNTANT **n**

A person whose job is to keep or check financial accounts.

Government **accountants** are scrutinizing the term of the deal.

ACQUIRE **v**

Obtain something.

He tried to **acquire** the information he needed.

CONCEPT **n**
An idea or abstract principle.

Generally, there are five accepted accounting principles and **concepts**.

CORPORATION **n**
A large business or company.

The digital equipment **corporation** will unveil a new line of its personal computers today.

CURRENT **adj**
Something that is happening, being done, or being used at the present time.

Our **current** methods of production are too expensive.

EXCHANGE **n**
Giving of one thing and receiving of another in its place.

Financial transactions represent the **exchange** of goods and services between economic entities.

DEED **n**
A legal document containing an agreement or contract.

The land was simply taken by the communists and the original title **deeds** have long since disappeared.

FASB **n**
Financial Accounting Standards Board.

The **FASB** has considered the problem of inflation and has required that basic financial statements of the largest corporations be supplemented with information on changing prices.

FUTURE **n**

Period of time after the present.

Assets are considered to have future economic benefits.

GENERAL **adj**

Something that relates to the whole of something, or to most of it, rather than to any particular detail or part.

The **general** standard of education there is very high.

INDEX **n**

A system by which changes in the value of something can be compared or measured.

We have experienced a 3 percent rise in the wholesale prices **index**.

INVESTOR **n**

A person who buys shares or who pays money into a bank in order to receive a profit.

The **investor** is entitled to reasonable return on his money.

INVOICE **n**

An official document that lists the goods or services that you have received from a person or company and says how much money you owe them.

The families were stunned when they read **invoices** billing them for several thousand dollars.

PRINCIPLE **n**

A general rule or scientific law about how something happens or works.

The cost **principle** specifies that assets acquired by a business entity are to be recorded at the exchange price paid for them.

RECORD **n**

Keep a written account of something or store information about it in a computer.

Keep a **record** of any repair bills.

SOLVENCY **n**

A country or organization’s ability to pay back its debts.

More can be exported to preserve Hungary’s precarious **solvency**.

STABLE **adj**

Something that is not likely to change or come to an end suddenly.

Oil prices are **stable** for the first time in years.

Vocabulary

Exercises 9.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. acquire	a. company
2. concept	b. bill
3. exchange	c. obtain
4. index	d. consumer
5. invoice	e. seller
6. record	f. basis
7. stable	g. present
8. principle	h. idea
9. current	i. official report
10.	j. indication
	k. steady
	l. trade

Generally Accepted Accounting Principles

So far you saw the need to have some standards developed so that the financial statement-the income statement, the statement of owner's equity, and the balance sheet-can be useful to investors and creditors. This need related in the development of generally accepted accounting principles, which are continually revised by the FASB. There are many principles, and as we take up topics, we'll discuss the principles related to those topics. But at this early point, we'll explore some basic and very important accounting principles that govern the preparation of financial statements.

Five generally accepted accounting principles and concepts behind them are presented in this section:

1. The cost principle
2. The objectivity principle

3. The business entity concept
4. The going concern concept
5. The stable-rial concept

The Cost Principle

The cost principle specifies that assets acquired by a business entity are to be recorded at the exchange price paid for them. The price the buyer pays in exchange for an asset is known as the historical cost. It is called a historical cost because, once recorded, the cost of the asset remains unchanged.

It is important to realize that the assets listed on the balance sheet are measured in rial amounts that represent the historical cost of those assets, not what presently could be obtained from their sale. The reason for the cost principle is given in the objectively principle.

The Objectively Principle

The cost of an asset is established by an exchange transaction between an informed buyer and an informed seller. Evidence of the exchange price agreed upon can be found in documents such as purchase invoices, sales invoices, property deeds, transfers of title, and other similar documents. The objectivity principle requires that this exchange price- the historical cost- can be confirmed by any independent party by simply reviewing the information in the sale documents (The term independent party means an unrelated person who does not have a financial interest in the business affairs of either the buyer or the seller).

The objectively principle establishes the reason for recording assets at cost. Any value other than cost could not be agreed upon by independent parties, even if they were expect in determining values of assets. Estimated market values are not based on fact and are not objective; they are subjective. Subjective means that they rest on the opinion of the one making the estimate.

The Business Entity Concept

For accounting purposes, a business entity is considered to be separate and distinct from its owner or owners. This basic, generally accepted accounting principle is called the business entity concept. For instance, when a travel agency and a dry- cleaning store are operated by the same person but as two separate proprietorships, the business transactions of each must be recorded, summarized, and reported separately, resulting in an income statement and a balance sheet for each enterprise. The purchase of a personal automobile by the owner of these two establishments would not be considered as relating to either business entity. Thus, accounting treats each business entity as generating its own revenue, incurring its own expenses, owning its own assets, and owning its own debts.

The Going Concern Concept

Business entities are established with the basic assumption of continued existence. Even though occasionally the entity may incur a loss, so long as the owner can reasonably expect future earnings that will yield profits, a business entity will continue to operate. Thus, accountants assume that a business entity will be in existence for as long as is necessary to complete any projects the business entity plans to undertake. This accounting principle is called the going concern concept. It is because of this concept that assets are considered to have future economic benefits. If we did not have this going concern concept, we would be forced to record all assets as expenses on the income statement. We would not know if any future benefit would be received from the asset, since the business entity might not be in operation next year.

For example a building typically has an estimated useful life of 40 years for accounting purposes, but its full cost is not recorded as an expense when acquired. Instead, because the business entity expects to be in existence 40 years hence, part of the cost of the building will be allocated to each of 40 successive annual income statements as an expense. The market value of the building today is not considered relevant to users of the financial statements, since the entity does not plan to sell those assets it needs to operate the business.

The Stable-Rial Concept

The mile and the kilometer are standard units that enable us to measure distances. If we know the distance between two cities, we can use that information to estimate the time to travel between them or how much gasoline is needed to make the tripe.

Money is the unit of measure employed in recording financial transactions. Knowing the money values assigned to financial transactions enables the users of financial statements to estimate the profitability of solvency of a business enterprise. But unlike the mile and the kilometer, the rial is not a precise and changeless unit of measure. A rial of 1980 is not the same as a rial of today, due to inflation.

Accountants know that the value of the rial changes over time, but they cannot build useful statements with unstable units of measurement. Therefore, they prepare financial statements based on the stable-rial concept. The term stable rial means that the rial of a past year is considered equal in value to a current rial. When we compare revenues of 1982 to revenues of 1990, the same rial is used to measure the revenues from each year. The accounting rial is thus assumed to be stable- it does not change in value over time. If only this were true! The rial does change in value of gasoline today? The measure of a gallon stayed the same, but the measure of a rial certainly didn't.

It is possible to present financial statements adjusted for current values, but to do so requires subjective judgments on the part to those preparing such statements. For example, we could adjust the $40000 cost of a building acquired several years ago to a current value by using the consumer price index (CPI).

While such information concerning current values can be useful, accountants feel that the objectivity inherent in the historical cost basis is more important. The FASB has, however, considered the problem of inflation and has required that basic financial statements of the largest corporations be supplemented with information on changing prices during periods of rapid inflation such as from 1979 to 1986.

Vocabulary and Comprehension Exercise

Exercise 9.2

Fill in the blanks with appropriate words from the following list.

going concern	basic accounting	business entity	inflation
stable	principles	assets	going concern
current			

1. A ……………. is an economic unit that engages in identifiable business activities.

2. The balance sheet of a business is prepared on the assumption that business is a continuing enterprise, a …………..

3. A balance sheet is merely detailed expression to the accounting equation, ……….= Liabilities + owner's equity.

4. Generally accepted ……………. require that a set of financial statements describe the affairs of a specific business entity.

5. The term ……….. rial means that the rial of a past year is considered equal in value to a ………. rial.

6. We have to record all assets as expenses on the income statement, if we don't have the ………….. concept.

7. Record the financial transactions within the framework of the ……………. model is the first step to produce the financial statements.

8. The rial isn't a precise and changeless unit of measure because of ………..

Comprehension Exercises

Exercise 9.3

1. Which one does specify that assets acquired by a business entity are to be recorded at the exchange price paid for them?

a. The objectivity principle
b. The cost principle
c. The stable-rial concept
d. The going concern concept

2. Which one does require that exchange price can be confirmed by any independent party by simply reviewing the information in the sale documents?

a. The cost principle
b. The objectivity principle
c. The business entity concept
d. The going concern concept

3. Which one does state that "for accounting purposes, a business entity is considered to be separate and distinct from its owner or owners"?

a. The objectivity principle
b. The cost principle
c. The stable-rial concept
d. The business entity concept

4. Which one is related to this fact that assets have future economic benefits?

a. The going concern concept
b. The objectivity principle
c. The business entity concept
d. The cost principle

5. Which one does help to accountants to remove the rial changes over time?

a. The objectivity principle
b. The cost principle
c. The stable-rial concept
d. The going concern concept

Exercise 9.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1. …… The assumption that a business entity will remain in business as far into the future as is necessary to complete any projects the business plans to undertake is called the going concern concept.

2. ……. The process of recording each business transaction by balancing two elements within the basic accounting model is double entity accounting.

3. ……. The stable-rial concept assumes that the entity will be in existence for the foreseeable future.

4. …… All financial transactions can be analyzed in terms of the basic accounting model.

5. ……. The cost principle states that: the value of an asset is determined by the consumer price index.

6. ……. The recording of a building as an asset rather that an expense is an illustration of the objectively principle.

7. ……. The objectively principle states that: objective, verifiable evidence must underlie the recording of business transactions.

8. …... The business entity is regarded as being separate from the personal affairs of its owner.

9. …... If the owner was to intermingle his personal affairs with the transactions of a business, the resulting financial statements would be misleading and would fail to describe clearly the activities of the business entity.

10. …… It is not appropriate to ask accountants do not change the recorded values of assets to correspond with changing market prices for properties.

Exercise 9.5

After reading the text, try to provide full answers to the following questions.

1. How could you explain the “business entity concept”?
2. What is the basic assumption for establishing a business entity?
3. How do you consider an automobile, if it is purchased for personal use of the owner?
4. How does the money value assigned to financial transactions, help the users of the financial statements?
5. Why isn’t the full cost of an asset with estimated useful life of 40 years recorded as an expense when acquired?
6. How does accounting treat each business entity?

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

THE BASIC ACCOUNTING MODEL

The goal of the accounting activity for a business entity is to prepare financial statements that describe the entity. These statements cannot be prepared until the financial transactions of the business entity have been recorded, classified, and summarized. All financial statements rely on a simple relationship called the basic accounting model, expressed by the balance sheet equation:

Assets = Liabilities + Owner’s Equity

A = L + OE

This fundamental equity is always true because the left side of the equation is simply another view of the right side. Assets represent resources owned by the business entity; liabilities and owner’s equity represent the claim of those who supplied the assets. Since owner’s equity represents the difference between assets and liabilities, the equation is always in balance.

Financial transactions represent the exchange of goods and services between economic entities. Each financial transaction affects the balance sheet equation. Consider, for example, the acquisition of an asset. Assets could be acquired by:

1. Paying cash-giving up an asset already owned. Buying an office desk by cash would be an example.

2. Giving a promise to pay the amount due at some future date-incurring a liability. Buying an office desk, but not paying for it until next month, would illustrate incurring a liability.
3. Accepting a receipt from the owner of the business entity-increasing the owner's equity in the business. If the owner of a business used his or her own personal desk in the business he would have acquired the desk from owner.

Can you see that each of these financial transactions has two parts? Assume that the desk costs $200 and the equation is as follows:

A	=	L	+	OE
$100000	**=**	**$60000**	**+**	**$40000**

On the one hand, acquiring the office desk by paying cash would increase the total assets of the business entity by the cost of the desk. But on the other hand, cash would be reduced by a like amount. The equation stays in balance:

A	=	L	+	OE
$100000	**=**	**$60000**	**+**	**$40000**
+200				
-200				
$100000	**=**	**$60000**	**+**	**$40000**

Acquiring the desk by incurring a liability would increase the total assets, but also increase the liabilities.

A	=	L	+	OE
$100000	**=**	**$60000**	**+**	**$40000**
+200	**=**	**+ 200**		
$100200	**=**	**$60200**	**+**	**$40000**

Acquiring the desk from the owner would increase the total assets, but also increase the owner's equity.

A	=	L	+	OE
$100000	=	$60000	+	$40000
+200	=		+	200
$100200	=	$60000	+	$40200

Since every transaction has two parts, the term double-entry accounting is used to refer to the recording of financial transactions.

Remember: the ultimate result of the accounting activity for an entity is its financial statements. The first step required to produce financial statements is to record the financial transactions within the framework of the basic accounting model.

Keywords

Concept	مفهوم	Independent	مستقل
Confirm	تأیید کردن	Informed	مطلع، مستحضر
Corporation	شرکت، مؤسسه	Inherent	ذاتی ،اصلی
Deed	مدرک، سند	Invoice	فاکتور، صورتحساب
Entity	مؤسسه مستقل	Preparation	آماده‌سازی
Established	محقق، محرز	Principles	اصول
Explore	کاوش کردن	Solvency	توانایی پرداخت‌بدهی، قابل وصول بودن
FASB	هیأت استانداردهای حسابداری مالی	Stable	با ثبات، پایدار
Historical cost	قیمت بازار	Supplement	مکمل، ضمیمه
Incur	متحمل شدن	Title	حق مالکیت

Answer Key

In this section you can compare your answers to the different questions, thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 9-1

1. c	2. h	3. l	4. j
5. b	6. i	7. k	8. f
9. g	10.a		

Exercise 9-2

1. business entity	2. going concern	3. assets	4. principles
5. stable, curren t	6. going concern	7. basic accounting	
8. inflation			

Exercise 9-3

1. b	2. b	3. d	4. a
5. c			

Exercise 9-4

1. T	2. T	3. F	4. T
5. F	6. F	7. T	8. T
9. T	10. T		

Exercise 9-5

1. For accounting purposes, a business entity is considered to be separate and distinct from its owner or owners. This basic, generally accepted accounting principle is called the business entity concept.
2. It is the continued existence of the business entity.
3. The purchase of a personal automobile by the owner would not be considered as relating to his business entity.
4. It enables the users of financial statements to estimate the profitability or solvency of a business enterprise.
5. Because the business entity expects to be in existence 40 years hence, part of the cost of the building will be allocated to each of 40 successive annual income statements as an expense.
6. Accounting treats each business entity as generating its own revenue, incurring its own expenses, owning its own assets, and owing its own debts.

Chapter 10

Definitions of Management

General Objectives

This unit has been designed to help you to:

- Know definitions of management.
- Evaluate the role of professional manager.
- Explain features of management.
- Distinguish between internal and external factors that influence management.

Behavioural Objectives

After reading the text, students are expected to:

- Learn and define the key terms and general words about management.
- Be able to use these words in related passages.
- Distinguish and apply different parts of speech of the given words.
- Do the relevant exercises.

Vocabulary Help

APPOINTMENT **n**

1. An arrangement to meet at a particular time and place.
2. A job or position, the action or process of appointing someone.
3. (Appointments) furniture or fittings.

Specialization in every field, technological advancement, globalization of business results in to **appointment** of qualified managers at every level.

APPROACH **n**

A way of dealing with something

Use of an effective marketing **approach**: Answering the basic marketing questions and acting on that information is essential to the success of your product.

AUTOCRATIC **adj**

(Autocrat) a ruler who has absolute power

Sometimes, **autocratic** management can help organizations.

CHALKING **v**

(Here) Achieve something

The typical managers help organizations in **chalking** out corporate strategies.

COMMUNICATION **n**

The action of communicating, (communications)the means of sending or receiving information, such as telephone lines or computers.

The foundation of all relationships is **communication.** Without communicating effectively, we are not able to achieve our goals and objectives.

CONTROLLING **v**

Have control or command of people

Management is Planning, Organizing, **Controlling**, Direction, and Co-ordination, supported by leadership communication, motivation and morale.

COORDINATING **v**

Bring the different elements of organization into an efficient relationship.

Coordinating is one of the most important factors of efficient management.

CONNOTATIONS **n**

An idea or feeling

Management as a subject is dynamic, so the term 'Profession' or 'Professional Manager' has got different **connotations.**

CREDENTIALS **n**

A qualification, achievement, etc, especially when used to indicate suitability.

To prove your **credentials** (as a manager), you may adopt short-term approach towards business strategy which may be harmful for the company in the long run.

DIRECTING **v**

Control the operations of organization

The essential task of an economy is **directing** resources into useful goods and services (the act of production), then distribute or allocate these products to useful ends (the act of consumption).

FEATURE **n**

A distinctive attribute or aspect of something.

Could you please explain **features** of management?

INTUITION **n**

The ability to understand something immediately.

Managers try to have knowledge based decision making instead of **intuition** and individual based decision making.

LEADERSHIP **n**

The person who leads, commands, or precedes a group, organization, or country.

Malaysia had impressive Economic progress under Mahatir Mohammad leadership.

MANAGEMANT **n**

The process of managing.

Academic Approach and Practical Approach both signify the importance of **management** as a profession.

MOTIVATION **n**

Enthusiasm

Advertisement can increase consumer **motivation** for using a production.

ORGANISING **v**

Arrange systematically. Form (people) into a trade union or other political group.

Organizing as a process: Any activity, for e.g., organizing a seminar, a departmental function, project management has common steps which are applicable anywhere.

PLANNING **v**

Intention or decision about what one is going to do.

Planning is imperative in an uncertain environment.

PREDICTION **n**

If you make a prediction, you say what you think will happen.

Proponents of behavioral economics have not conclusively demonstrated that paying closer attention to psychological thought processes can improve economic **predictions**.

PROFESSION **n**

A paid occupation

Any discipline to be called, as profession must fulfill the certain conditions.

Vocabulary

Exercises 10.1

Match the words in column A with their appropriate equivalent in column B. There are more choices in column B than required.

Column A	Column B
1. approach	a. aspect
2. organize	b. job
3. direct	c. standard
4. feature	d. arrange
5. profession	e. apportion
6. predicting	f. understanding fast
7. plan	g. command
8. intuition	h. map
	i. forecasting
	j. method

Definitions of Management

Definitions

1. Management is Planning, Organizing, Controlling, Directing, and Co-ordination, supported by leadership communication, motivation and morale.
2. Management is getting things done through and with other people.
3. By Koontz and O'Donnell "Management has been defined as the creation and maintenance of internal environment in an enterprise, where individuals working together in groups can perform efficiently and effectively towards the attainment of group goals".
4. By Peter Ducker, "Management is a multipurpose organ that manages a business, manages a manager and manages workers and work".
5. By Apply L, "Management is the attainment of pre-established goals by the direction of human performance along pre-established lines. It is management of people and not the direction of thing".
6. Management is management of Men, Money, Machinery, Materials and information.

Features of Management

1. Management is purposeful and goal oriented (It has definite economic and social objectives)
2. Management is Universal (Applied everywhere)
3. Management is situational (Differs from situation to situation)
4. Management is continuous process.
5. Management is creative.
6. Management is multidisciplinary (It includes knowledge/ information from economics, math, statistics, psychology, sociology etc)
7. Management is dynamic (Changes as per time)
8. Management is what management does (Management is understood by performance)

9. Management is influenced by internal and external environmental factors.

Internal Factors	External Factors
a. Place	a. Economic factors
b. Labor	b. Political
c. Machines	c. Legal
d. Money	d. Social
	e. Cultural
	f. Climatic
	g. Technological
	h. Global
	i. Ethical
	j. Moral

10. Management exists at all levels in the organization.

As mentioned above, these different definitions fail to understand the scope and nature of management. So, additional features clarify the term management.

Management is the combination of Arts Science and Profession

Management as an Art

The following features of an Art can be compared with that of management.

1. Art requires skill.

Management requires Conceptual, Technical, Human Relations and Decision making skills.

2. Art requires knowledge.

Management also requires learning and acquiring knowledge from various subjects such as Marketing, Finance, and Production etc.

3. Art is Creative.

Management as a discipline is the function of creativity. We notice this creativity in facing challenges of competition. Introduction of new product, advertising campaigns etc.

4. Art is personalized.

Every person has different ways and means of performing art. Similarly, every individual has different style of management. We categories them as Democratic, Autocratic, Paternalistic, Beaurocratic, etc.

5. Art is Performance.

Performance indicators such as Profit, Growth and Development, Market Share can only understand management as a concept. As good and bad in Art form is relative/subjective, Good and Bad management is also understood by the above and various other performance indicators.

Management as a Science – Social Science

1. Science is a body of organized knowledge.
2. Science is developed over a period of time.
3. Science establishes cause and effect relationship.
4. Science has predictive power.
5. Rules/Regulations in Science are verified from time to time. Old rules are challenged, new rules are established.
6. Science is of two types: Perfect Science like Physics/Chemistry/Math's and Social Science like management.

The above rules of Science can also be applied to Management as a Social Science which consists of history of management thought. Management as a subject has developed over a period of time. Generalizations in Management such as "If you spend more money on Advertising, sales may go up".

If you keep employees happy there may not be any labor strike.

These words (may happen/ may not happen) make management a social Science.

Management as a Profession

Is management a profession?

A. Academic Approach: This is one of the widely discussed and debated aspects of management. Theoretically and academically management is developing towards a profession. We have to compare the characteristics of profession with that of management.

What is a profession?

Any discipline to be called, as profession must fulfill the following conditions (Law and Medicine can be called as full fledged professions as all the characteristics mentioned below are applicable to law and medicine. Regarding management discipline, there are doubts at every stage. To some extent, they are not applicable).

Profession

1. It requires a definite period of learning.
2. It has centralized rule making authority.
3. It has enforceable code of conduct.
4. Membership through acquired qualification and approval.
5. It needs certificate of practice.
6. Social commitment/obligation/accountability.

If we compare the above features of a profession with that of management, we get confusing signal.

1. Anybody can become a manager. Designation of a manager does not require any specific qualifications or a definite period of learning. At the same time many organizations prefer individuals with MBA, DBM qualifications for the post of a manager.
2. Management as a discipline has no centralized rule making authority. There are a number of parent bodies in specialized functional areas such as Institute of Marketing Management, Institute of Materials Management, National Institute of Personnel Management and so on.
3. These parent bodies can publish a desirable code of conduct, but that cannot be enforced as law in management.
4. There are many businesses that are managed/controlled/owned by various business families in the world such as Toyota, Puma,

Honda, Ford and etc. Individuals born in business families get ownership Right/ Management right mainly due to the law of inheritance. It is irrespective of the qualification they hold.

5. Management as a discipline does not require any certificate practice. There is no legal definition of the term manager. Institute of Chartered Accountancy/ Company Secretary/ Cost Accountant are exceptions as their membership is based on professional qualification acquired in the field as well as certificate of practice issued by respective institutes.
6. Managers do have a social commitment / accountability / obligation. This is the part of social responsibilities of management. These responsibilities are desirable and not enforceable under every law.

B. Management as a profession or the concept of professional manager (practical approach)

Management as a subject is dynamic, so the term 'Profession' or 'Professional Manager' has got different connotations. This approach is very close to the practice of management. This approach clarifies role of profession manager as well as who can be called as professional manager.

At the outset, it must be made clear that Professional management is a mindset that signifies:

1. Separation of ownership from management.
2. Knowledge based decision making instead of intuition and individual based decision making.
3. It is based on expertise and experience of a manager in the requisite field.
4. Professional managers are objective/focused/performance oriented.
5. They help organizations in chalking out corporate strategies.
6. They help in meeting competitive challenges of business.

7. Specialization in every field, technological advancement, globalization of business results in to appointment of qualified managers at every level. They can be called as professional managers.
8. Professional managers are creative/dynamic.
9. They follow management practices based on world wide experiences and information.
10. They apply theories of management to solve emerging organizational problems.

The other side of Professional Managers

There are some aspects of professional managers, which are criticized the world over such as:

1. Professional managers are committed towards their profession and not to the organization. With attractive salary offer from another company, they may hope in to another job. This raises questions relating to their loyalty towards the organization.
2. They may have only salary stake. This results in to the question of accountability of their performance.
3. Their views and owner's views (in case of family owned/managed business) may clash which will result in to uncertainty in the organization.
4. To prove their credentials, they may adopt short-term approach towards business strategy which may be disastrous for the company in the long run.
5. Last but not the least how much freedom they will get to run the company?

Vocabulary and Comprehension exercise

Exercises 10.2

Fill in the blanks with appropriate words from the following list.

theory	environmental	model	Conceptual
wants	economics	scope	clarify
people	Science	Profit	profession

1. Management is getting things done through and with other ……………..
2. Management is multidisciplinary field; it includes knowledge/ information from ………, statistics, psychology and sociology.
3. In management, we have internal and external ……………factors.
4. As mentioned in the text, these different definitions fail to understand the ……….and nature of management. So, additional features …..….the term management.
5. Management needs …………, Technical, Human Communication and Decision making skills.
6. Performance indicators such as Income, ………….. , Market Share can only understand management as a concept.
7. Rules/Regulations in …………….are verified from time to time. Old rules are challenged, new rules are established.
8. Professional managers are committed towards their …………. and not to the organization

Comprehension Exercises

Exercise 10.3

First read the text carefully and then choose the best choice to complete each question.

1. Which one <u>is not belong</u> to social sciences?

a. economics
b. biology
c. accounting
d. management

2. Which one belongs to external environmental factors of management?

a. political
b. place
c. money
d. labor

3. According to the passage, which one of the following issues <u>is not</u> the subject matter of management?

a. planning
b. controlling
c. directing
d. political election

4. Academic Approach and Practical Approach both signify the importance of management as a profession. It is said that:

a. Management is just a process
b. Management is just a list of functions
c. Management is just Arts and science
d. Management is and should be a way of life

5. Management requires Conceptual, Technical, human Relations and Decision making skills. So it is like:

a. Rationality assumption
b. models
c. art
d. theories

Exercise 10.4

Read each statement and decide whether it is true or false. Write "T" before true statements and "F" before false statements. Base your answers on the information given in the passage.

1.…… Management is the study of how people make choices.
2.……. Management is purposeful and goal oriented.
3.……. Management is the combination of art, science and profession.
4.…….. Management is a social science that employs the same kinds of methods used in other sciences.
5.…….. If you spend more money on Advertising, sales definitely go up.

Exercise 10.5

After reading the text, try to provide full answers to the following questions.

1. What are the features of management?
2. What is the definition of term 'Management'?
3. Write short notes on:
   a. Management is universal
   b. Management is multi-disciplinary
   c. Management is a social science
   d. What management does?
4. 'Management is the combination of Arts, Science and Profession'. Comment with examples.
5. Explain the role of professional managers in the Iranian Corporate Sector.

Translation Practice

Translate the following text into fluent Persian. Use a dictionary if necessary.

Organizing

In the management process, the most misunderstood and misinterpreted word is 'organizing'. It is viewed differently and various concepts are linked with it. For the sake of simplicity and clarity, it is defined in five different ways as follows:

1. Organizing as a process
2. Organizing as a structure of authority
3. Organizing as relationship
4. Organizing as an establishment
5. Organizing as corporate citizen (Social aspect of organization)

1. Organizing as a process: Any activity, for e.g., organizing a seminar, a departmental functions, project management has

common steps which are applicable anywhere. This process is universal and applied to organize any social or commercial activity.

a. Prepare the list of activities to be performed
b. Classify and group these activities
c. Appoint people to perform these activities
d. Assign them authorities and roles
e. Specify the scope of activities
f. Follow-up and review the performance

Any activity can be organized following the above process and that is why this definition is widely accepted and applied in the subject matter of management.

2. Organization as a structure of authority: Every organization is carried out of authority and responsibility structure. Authority exists at every level and we have structure of top, middle and lower levels in the organization. The subject matter of delegation, decentralization, span of management are a part of this definition.
3. Organization as a Relationship: Organization consists of individuals; their formal roles and structural positions bring them closer. This set-up is called the 'set-up of relationships' namely formal and informal relationships. The subject matter of communication, motivation, organizational politics and study of organizational behavior can be brought under the perspective of this definition.
4. Organization as an Establishment: This is the physical aspect of an enterprise. It is known by its registered name, location, and address and identified by structure or various branches and divisions.
5. Organization as a Corporate Citizen: Comparatively latest approach signifies organization as a part of social system. An organization is like an individual who constantly interacts with the society, influenced by image-building process and identity. The topics of social responsibilities of an enterprise are covered under this approach.

Keywords

Authority	قدرت،اختیار	Interact	تأثیرمتقابل
Commercial	تجاری	Misinterpret	اشتباه تفسیرکردن
Decentralization	عدم تمرکز، تمرکززدایی	Organizing	سازماندهی
Delegation	نمایندگی	Performance	عملکرد
Establishment	استقرار، تأسیس	(For the) Sake	به دلیلِ
Image-building	ساخته ذهن		

Answer Key

In this section you can compare your answers to the different questions; thereby you have the opportunity to appraise your understanding of the lesson as well as your competence in English.

Exercise 10-1

1. j	2. d	3.g	4. a
5. b	6. i	7. h	8. f

Exercise 10-2

1. people	2. economics	3. environmental	4. scope, clarify
5. conceptual	6. profit	7. science	8. profession

Exercise 10-3

1. b	2. a	3. d	4. d
5. c			

Exercise 10-4

1. F	2. T	3. T	4. T
5. F			

Exercise 10-5

1. In nutshell, Management is purposeful, goal oriented, universal, situational, creative and multidisciplinary.

2. Management is Planning, Organizing, Controlling, Directing, and Co-ordination, supported by leadership communication, motivation and moral.
3.
    a. Applied everywhere
    b. It includes knowledge/ information from economics, statistics, psychology, sociology etc.
    c. Science is a body of organized knowledge and has predictive power.
    d. 'Management is getting things done through and with other people'.
4. Find it in the text.
5. It depends on your idea and the organization that you know properly.

Appendix
Words and Meanings

accountant حسابدار
acquire به‌دست آوردن
alternative جایگزین
anticipated inflation تورم پیش‌بینی شده
appointment قرار ملاقات
approach روش
asset دارایی
asymmetric information اطلاعات نامتناسب
autocratic صاحب قدرت
balance sheet ترازنامه
barter تهاتر
behavioral economics رفتار اقتصادی
bounded rationality انتخاب عقلایی
capital سرمایه
capital good کالای سرمایه‌ای
central bank بانک مرکزی
ceteris paribus ثابت بودن سایر عوامل
chalking (در اینجا) به‌دست آوردن چیزی
commodity کالا
communication ارتباطات
competition رقابت
complement مکمل
concept مفهوم
connotations دلالت، ایده یا احساس
consumer مصرف‌کننده
consumption مصرف
controlling کنترل کردن
coordinating هماهنگی کردن
corporation تعاونی
credentials لیاقت، اعتبارنامه
creditor بستانکار
current جاری
curve منحنی
cyclical unemployment بیکاری دوره‌ای
debtor بدهکار
deed سند
demand تقاضا
desire آرزو
directing راهنمایی کردن
durable consumer goods کالای مصرفی بادوام
economic growth رشد اقتصادی
economics علم اقتصاد
economy اقتصاد
efficiency کارایی
entrant داوطلب
entrepreneurship کارآفرین،مالک بنگاه
equilibrium تعادل
evaluate ارزشیابی
exchange مبادله
expectation انتظار
expenditure approach روش مخارج
expenses. مخارج
export صادرات
externality پی‌آمد خارجی
failure شکست
FASB هیأت استانداردهای حسابداری مالی
feature آینده
fee اجرت، پردازه
fiduciary monetary system سیستم پول معتبر

final goods and services کالاها و خدمات نهایی
finance مالی
financial intermediaries واسطه هارمانی
fire اخراج
firm بنگاه
fixed investment سرمایه‌گذاری ثابت
forgo صرف‌نظر شده
free-riders سواری مجانی
frictional unemployment بیکاری اصطکاکی
future آینده
general عمومی
goods کالاها
government-inhibited good کالاهای ممنوع شده از طرف دولت
government-sponsored goods. کالاهای حمایت شده از طرف دولت
gross domestic production (GDP) تولید ناخالص داخلی
household خانوار
human capital سرمایه انسانی
income درآمد
incurred رخ داد
index شاخص
individual شخصی
inflation تورم
inhibit ممنوع کردن
interest بهره
interest rate نرخ بهره
intermediate good کالای واسطه‌ای
intuition بصیرت، دریافت ناگهانی
inventory investment سرمایه‌گذاری در موجودی انبار
invest سرمایه‌گذاری
investment سرمایه‌گذاری
investor سرمایه‌گذار
invoices فاکتور، صورتحساب
job leaver ترک کار اختیاری
job losers از کار اخراج شده
labor کارگر
land زمین
leadership رهبری
liabilities تعهدات
limited محدود
liquidity نقدینگی
loan وام
macroeconomics اقتصاد کلان
management مدیریت
market بازار
measuring اندازه‌گیری
microeconomics اقتصاد خرد
models, or theories مدل‌ها یا تئوری‌ها
money پول
moral hazard خطر اخلاقی
motivation انگیزش
nature طبیعت، خصوصیت
needs نیازها
new entrants تازه بیکار شده
nominal اسمی
nondurable consumer goods کالای مصرفی بی‌دوام
normative economics اقتصاد دستوری
opportunity cost هزینه فرصت
organizing سازمان‌دهی کردن
output محصول
owner مالک
ownership مالکیت
performance عملکرد
planning برنامه‌ریزی کردن
positive economic اقتصاد اثباتی
prediction پیش‌بینی
predictions پیش‌بینی
preference ترجیح

price قیمت
principle اصل
production تولید
production possibilities curve
منحنی امکانات تولیدی
profession شغل، حرفه
profit سود
proprietorship مالکیت
public goods کالاهای عمومی
public spending مخارج عمومی
purchase خریدن
purchasing power قدرت خرید
quantity مقدار
rationality خردمندانه
real واقعی
record ثبت
redistribution توزیع مجدد
reentrant منتظر کار
regulations قوانین
rent اجاره
resources منابع
revenue درآمد
rival consumption مصرف رقیب
salary حقوق، دستمزد
satisfaction رضایتمندی
scarcity کمیابی
schedule جدول
seasonal unemployment بیکاری فصلی
security امنیت
service خدمت
services خدمات
shortage کمبود
solvency قابل وصول بودن
spending مخارج
sponsor حامی
stability پایداری
stable پایدار
statements صورتحساب
structural unemployment.
بیکاری ساختاری
subsidize یارانه دادن
substitute جانشین
supply عرضه
surplus مازاد
taxation مالیات
third parties شخص ثالث، گروه سوم
thrift institutions مؤسسات پس‌انداز
total income درآمدکل
trade-offs مبادله
transaction مبادله
transaction deposits حساب‌های اعتباری
traveler’s checks چک‌های مسافرتی
unanticipated inflation
تورم پیش‌بینی نشده
unemployment بیکاری
unit of accounting
واحد شمارش (قیمت‌ها)، واحد حسابداری
utility expenses مخارج اولیه
value added ارزش افزوده
voluntarily اختیاری
wage دستمزد
wants خواسته‌ها
withdrawals برداشت پول از حساب

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خوانندهٔ محترم

این پرسشنامه به منظور ارتقای کیفیت کتاب‌های درسی و رفع نواقص آن‌ها تهیه شده است. دقت شما در پاسخگویی به این پرسشنامه در پایان هر نیمسال ما را در تحقق این هدف یاری خواهد کرد.

نام کتاب .... نام مؤلف/مترجم .... سال انتشار ....

پاسخگو: عضو علمی پیام‌نور ☐ عضو علمی سایر دانشگاه‌ها ☐ رشتهٔ تخصصی .... سابقهٔ تدریس ....

دانشجوی پیام‌نور ☐ دانشجوی سایر دانشگاه‌ها ☐ رشتهٔ تحصیلی .... ورودی سال ....

سؤال	خیلی زیاد	زیاد	متوسط	کم	بسیار کم
۱. آیا از زمان تحویل و نحوهٔ دسترسی به کتاب راضی بودید؟					
۲. آیا حجم کتاب با توجه به تعداد واحد مناسب بود؟					
۳. آیا راهنمایی‌های لازم برای مطالعهٔ کتاب منظور شده بود؟					
۴. آیا در ترتیب مطالب کتاب سلسله مراتب شناختی (آسان به مشکل) رعایت شده بود؟					
۵. آیا تقسیم‌بندی مطالب در فصل‌ها یا بخش‌ها متناسب و بجا بود؟					
۶. آیا متن کتاب روان و ساده و جمله‌ها قابل فهم بود؟					
۷. آیا به‌روزبودن مطالب و آمارها رعایت شده بود؟					
۸ آیا مطالب تکراری داشت؟					
۹. آیا پیوستگی مطالب با درس‌های پیش‌نیاز رعایت شده بود؟					
۱۰. آیا مثال‌ها، شکل‌ها، نمودارها، جدول‌ها و ... گویابودند و درفهم مطلب تأثیر داشتند؟					
۱۱. مطالعهٔ هدف‌های کلی، آموزشی/ رفتاری تا چه اندازه به درک بهتر شما کمک کرد؟					
۱۲. آیا خودآزمایی‌های کتاب به‌گونه‌ای بود که تمام مطالب درسی را شامل شود؟					
۱۳. آیا پاسخ خودآزمایی‌ها و تمرین‌ها کامل و گویا بود؟					
۱۴. چقدر با غلط‌های املایی و اشکال‌های چاپی مواجه شدید؟					
۱۵. آیا از کیفیت چاپ و صحافی کتاب راضی بودید؟					
۱۶. آیا طرح روی جلد کتاب با مطالب کتاب تناسب داشت؟					
۱۷. چنانچه دانشگاه وسایل کمک‌آموزشی از قبیل نوار، فیلم، لوح فشرده و ... در اختیارتان گذارده، آیا به درک بهتر شما کمک کرده‌اند؟					
۱۸. تا چه اندازه این کتاب شما را از حضور در کلاس بی‌نیاز کرد؟					

در مجموع کتاب را چگونه ارزیابی می‌کنید؟ عالی ☐ خوب ☐ متوسط ☐ ضعیف ☐ بسیار ضعیف ☐

لطفاً چنانچه با اشکال‌های تایپی یا محتوایی و مطالب تکراری مواجه شده‌اید، فهرستی از آن‌ها را با ذکر شمارهٔ صفحه ضمیمه کنید. در صورت تمایل سایر پیشنهادهای خود را نیز بنویسید.

این پرسشنامه را پس از تکمیل از کتاب جدا کنید و به قسمت آموزش مرکز تحویل دهید یا مستقیماً به نشانی تهران، صندوق پستی ۳۳۳-۱۴۳۳۵، مدیریت تولید محتوا و تجهیزات آموزشی کتاب ارسال فرمایید. آدرس وبگاه ما www.pnu.ac.ir است. با ورود به وبگاه، مسیر زیر را طی نمایید: ساختار دانشگاه/ معاونت‌ها/ فناوری اطلاعات/ مدیریت تولید محتوا و تجهیزات آموزشی.

با تشکر

مدیریت تولید محتوا و تجهیزات آموزشی