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> Glossary of Economic Terms



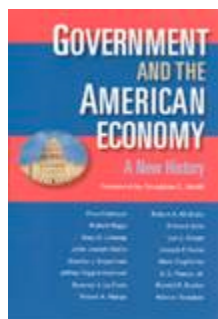
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Glossary of Economic Terms

AnalysisOnline Glossary of Economic Terms

A

Absolute Advantage

The ability of a producer to produce a higher absolute quantity of a good with the per unit resource available.

Abundance

A term that applies when individuals can obtain all the goods they want without cost. If a good is abundant, it is free.

Accelerator

The causal relationship between changes in consumption and changes in investment.

Activist Fiscal Policy

Use of the federal governments taxing, spending and borrowing powers in order to stimulate economic growth and employment.

Actual Turnover

The number of times individuals actually spend their average money holding over a period of time. Actual turnover is determined by the proportion of income that people actually retain as money balances over a given period of time.

Antitrust Laws

Designed to promote open markets by limiting practices that reduce competition.

Assets

What a person or business owns.

Automatic Stabilizers

Measures built into the governments budget that cause its spending to increase and revenues to decrease when the economy goes into slumps, and that cause government expenditures to decrease and taxes to increase when the economy goes into booms.

B

Balance of Payments

A record of all the financial transactions between a country and the rest of the world in a given year.

Bank Reserves

The total quantity of Federal Reserve notes held in bank vaults or checkable deposits at the banks at the Fed district banks.

Benefits in Kind

Non cash forms of pay or assistance.

Bracket Creep

The process by which inflation drives personal incomes upward into higher tax brackets in a progressive income tax system, this causes an increase in tax burdens.

Bretton Woods

An international monetary system operating from 1946-1973. The value of the dollar was fixed in terms of gold, and every other country held its currency at a fixed exchange rate against the dollar; when trade deficits occurred, the central bank of the deficit country financed the deficit with its reserves of international currencies.

Business Cycles

Periodic swings in the pace of national economic activity, characterized by alternating expansion and contraction phases.

C**Capital**

The existing stock of productive resources, such as machines and buildings, that have been produced.

Capital Intensive

Production methods with a high quantity of capital per worker.

Capitalist Economies

Economies which use market-determined prices to guide people's choices about the production and distribution of goods; these economies generally have productive resources which are privately owned.

Central Bank Intervention

Influence on exchange rates in the foreign exchange market when exchange rates are fixed by law; i.e., a central bank buys its country's currency with foreign currencies to drive it up in value; to drive it down, a central bank sells its currencies in return for foreign currencies.

Change in Demand

A shift in the entire demand curve so that at any given price, people will want to buy a different amount. A change in demand is caused by some change other than a change in the goods price.

Change in Quantity Demanded

Movement up or down a given demand curve caused by a change in the goods price, resulting in a shift in the curve itself.

Change in Quantity Supplied

A price change causing movement along the supply curve but no shift in the position of the curve itself.

Change in Supply

A change in one of the cost determinants of supply causing a shift in the position of the supply curve. Choice: The act of selecting among alternatives, a concept crucial to economics.

Civilian Labor Force

All persons over the age of sixteen who are not in the armed forces nor institutionalized who are either employed or unemployed.

Common Property Resources

Resources for which there are no clearly defined property rights; property owned in common by a society.

Comparative Advantage

The ability of a producer to produce a good at a lower marginal cost than other producers. The marginal cost in the sacrifice of some other good compared to the amount of a good obtained.

Competition

Rivalry among individuals in order to acquire more of something that is scarce.

Complements

A price change for one product leads to a shift in the opposite direction in demand for another product.

Comprehensive Employment and Training Act (CETA)

Federal funding for local governments to retrain and employ difficult-to-hire workers.

Consumer Price Index (CPI)

A measure of the average amount (price) paid for a market basket of goods and services by a typical U.S. consumer in comparison to the average paid for the same basket in a base year.

Consumption Expenditures

The total dollar value of all goods and services purchased by the household sector for its own use.

Consumption Function

A mathematical expression relating personal consumption expenditures to disposable income.

Contraction Phase

The part of the business cycle when GNP, employment and production are on the decline.

Corn Laws

Tariffs which England placed on grain imports from 1815 to 1846. By restricting the importation of grain into England, these laws raised the price of grain in England and increased the value of English farmland.

Cost

The most valuable opportunity forsaken when a choice is made.

Cost-of-Living Adjustments

Automatic adjustments in incomes paid to individual recipients which are tied to the rate of inflation, usually measured by the Consumer Price Index.

Cost-Push Inflation

A term that applies when increases in the price level are caused by increases in costs of production.

Council of Economic Advisors

Three persons who act as the President's chief economic advisers.

Craft Unions

Exclusive combinations of workers in individual trades such as printers, shoemakers, and bakers.

Credit

The capacity to borrow money up to a specified limit under specified conditions.

Crowding In

Increase of private investment through the income-raising effect of government spending.

financed by deficits.

Crowding Out

The tendency for federal government, by deficit financing to compete with firms or for borrowed funds; that is, firms and households unable to borrow at a low rate of interest curtail their investment and consumption spending.

Currency

Paper money issued by the government.

Current Account

A category in the balance of payments account that includes all transactions that either contribute to national income or involve the spending of national income.

Cyclical Unemployment

Temporary layoff of workers due to downturns in the pace of economic activity.

D**Deficit Spending**

A term which refers to the situation wherein the government spends more than it receives in taxes.

Demand

The maximum quantities of some good that people will choose (or buy) at different prices. An identical definition is the relative value of the marginal unit of some good when different quantities of that good are available.

Demand Curve

A graphic representation of the relationship between prices and the corresponding quantities demanded per time period.

Demand Deposits

Checking accounts in commercial banks. These banks are obliged to pay out funds when depositors write checks on those numbers. Checking accounts are not cash -- they are numbers recorded in banks.

Demand-Pull Inflation

A term used when an increase in aggregate demand occurs which cannot be offset by a corresponding increase in real supply causing an increase in the price level (inflation).

Diminishing Relative Value

The principle that if all other factors remain constant, an individual's relative value of a good will decline as more of that good is obtained. Accordingly, the relative value of a good increases, other factors remaining constant, as an individual gives up more of that good.

Diminishing Returns

As more and more of a productive resource is added to a given amount of other productive resources, additions to output will eventually diminish. Other factors, such as technology, the degree of specialization remaining constant.

Discount Rate

The interest a private bank pays for a loan from the US Federal Reserve System.

Discretionary Fiscal Policy

Changes in a fiscal (tax or spending) program initiated by the government in order to

aggregate demand.

Disequilibrium

The quantity demanded does not equal the quantity supplied at the going price.

Disinflation

A slowdown in the rate of inflation.

Disposable Income

The amount of an individual's income that remains after the deduction of income tax.

Dividends

Profits of a firm that are distributed to its investors (stockholders).

Division of Labor

Assigning of specific tasks to workers and productive resources; it is a reflection of specialization.

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E**Economic Growth**

A sustained increase in total output or output per person for an economy over a long period of time.

Economic Recovery Tax Act of 1981 (ERTA)

Designed to foster savings and investment to encourage long-term growth through reductions in personal income tax rates, taxes on personal savings for retirement and business firms investing in new capital.

Economic Regulations

The control of entry into the market, pricing, the extension of service by established firms, and issues of quality control.

Economic Specialization

Concentration of activity in a few particular tasks or in producing only a few items.

Economics

The study of choice and decision-making in a world with limited resources.

Efficiency

The allocation of goods to their uses of highest relative value.

Elasticity of Demand

The percentage change in the quantity demanded divided by the percentage change in price.

Embargo

A deliberate cutoff of supply, typically intended as a political statement.

Employment Act of 1946

Set full employment and price stability as national policy goals and established the Council of Economic Advisors.

Entitlements

Government transfer payments made to individuals having certain designated characteristics and circumstances, such as age or need.

Equation of Exchange ($M \times T = P \times Q$)

The equation indicates that the money supply multiplied by the number of times the turns over equals the price level multiplied by real output.

Equilibrium

The amount of output supplied equals the amount demanded. At equilibrium, there is neither a tendency to rise nor fall but clears at the existing price.

Exchange

The voluntary transfer of rights to use goods.

Exchange Rate

The price of one currency in terms of another.

Exchange Value

The purchasing power of a unit of currency for goods and services in the marketplace.

Exclusion Principle

The owner of a private good may exclude others from use unless they pay.

Expansion Phase

The phase of the business cycle when the economy is growing rapidly: output is increasing, employment is rising, industrial production is increasing and prices are tending to rise.

Externalities

Costs or benefits that impact society but are not included in the market price of a good or service. Pollution is an example of a negative externality. Education is an example of a positive externality benefit when members of society other than students benefit from a more educated population. Externality is one type of market failure that causes inefficiency.

F**Federal Debt**

The current dollar sum of obligations equal to the accumulated past deficits minus surpluses of the United States government.

Federal Deposit Insurance Corporation (FDIC)

A federal regulatory agency that insures all deposit accounts in member banks up to \$100,000.

Federal Reserve System

The US central bank consisting of 12 regional banks are run by a board of governors appointed by the president for overlapping 14-year terms; formally independent of executive and congressional branches of government; private bank members of the system own their assets.

Fiscal Policy

Those federal-government expenditure, tax and borrowing decisions that affect the national economic activity.

Fisher Effect

An increase in expected inflation causes a proportional increase in the market interest rate so that the expected real rate of interest remains unchanged.

Fixed Exchange Rates

The central bank holds the value of the currency constant against some foreign currencies. Fixed Inputs: Inputs that cannot be changed over a given time interval.

Floating Exchange Rates

The central bank allows market supply and demand to determine currency exchange

Foreign Currency Reserve

The foreign currencies that a central bank keeps on hand for intervention.

Free Good

A good which is abundant and costless.

Free Rider

One who receives something without paying.

Frictional Unemployment

Unemployment due to workers leaving old jobs and seeking new ones.

Friedman's Law

Inflation follows excessive monetary growth with a long (about two years) and variable lag. The rate of price change follows the rate of monetary growth.

G**Gains of Exchange**

The difference between the relative values of a good to the buyer and the seller. The difference is divided between buyer and seller will depend upon the price of the good. Exchange will not occur unless both the buyer and the seller expect to receive some gain.

GNP Deflator

Measure of the percentage increase in the average price of products in GNP over a base year (now 1972) published by the Commerce Department.

Good

Anything that anyone wants. All options or alternatives are goods. Goods can be tangible or intangible.

Government Budget Constraint

Total government outlays (the sum of expenditures on goods and services, transfer payments, and interest on debt) must equal total revenue (the sum of taxes and US government securities).

Government Security

A contract of the government promising to pay a lender a fixed rate of interest per year and repay the original loan at a fixed future date.

Government Transfer Payment

Outlays by the government for which no good or service is received in the current period.

Gross National Product (GNP)

The total market value, in terms of current dollars, of all final goods and services produced in the US in one year.

H**Hyperinflation**

Rapid, out-of-control inflation, at double digit rates per month and more, usually occurs only during wars and periods of severe political instability.

I**Income Policies**

Strategies to restrict wage and price increases, ranging from "jawboning" by the press to laws that set wage and price levels.

Income Statement

An annual summary of income and expenses of a given business in order to determine net income of the business.

Income Velocity of Money

The ratio of national income to the quantity of money in circulation; velocity measures the average number of times money changes hands in generating national income per year (monetarist theory).

Inelastic Demand

A term used when the percentage change in quantity demanded is smaller than the percentage change in price.

Indexation

Modifying contracts so that their dollar terms adjust to the inflation rate as measured by an index, such as the consumer price index.

Inflation

Increase in the overall level of prices over an extended period of time.

Interest

The annual earnings that are sacrificed when wealth is invested in a given asset or liability. The interest sacrificed by investing in a given business is often called the cost of capital.

International Monetary Fund (IMF)

The overseer for the exchange rate system and international monetary relations.

Inventory

A stock of goods or resources held by a buyer or seller in order to reduce the cost of carrying inventory, exchange or production.

Investment Expenditures

Dollar expenditures by firms on capital goods (factories, office buildings and others), structures, machinery and equipment, inventories and residential housing) used to produce other new goods and services.

Involuntary Unemployment

Potential workers able and willing to work at the existing market wage rate, are unemployed.

K**Keynesians**

A group of economists who emphasize an activist governmental role in economic affairs through planned changes in the federal government's expenditures and taxes.

L**Labor Intensive Methods**

Use of low quantity of capital per worker.

Labor Productivity

The ratio of real output per unit of labor input; growth is measured by a higher ratio of outputs to inputs.

Large Econometric Models

Mathematical constructions of national economics used for policy analysis and forecasting.

Law of Demand

People purchase more of any particular good or service as its relative price falls; they purchase less as its relative price rises.

Law of Supply

At higher relative prices, the quantity supplied of a good will increase; at lower relative prices, smaller quantities will be supplied.

Legal Tender

Paper dollars and coins mandated as acceptable means of payment by the government.

Leisure

All uses of time in which one's labor services are not exchanged for money. The use of everyone's time can be divided between employment and leisure.

Liabilities

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

Libertarianism

The view that government's role should be minimal, rarely interfering in the personal lives of private citizens.

Lorenz Curve

A graph which visually presents a measure of the inequality of a nation's income distribution.

M**M1**

The total quantity of coins and paper currency classified as legal tender by government mandate that circulates in the hands of the public, plus all checking account balances that public maintains in financial institutions.

M2

All of M1 plus savings, small time deposit account balances (less than \$100,000) in financial institutions and small money market mutual funds owned by individuals.

Macroeconomics

The study of the sum total of economic activity, dealing with the issues of growth, inflation, and unemployment and with national economic policies relating to these issues.

Malthusian Trap

The minimum subsistence level to which humans descend as a result of geometric population growth and arithmetic resource growth.

Managed Floating

Intervention by central banks in foreign exchange markets to stabilize their currencies and exchange rates.

Marginal

The additional or extra quantity of something. If one drinks six sodas in a day, the marginal soda is the seventh.

soda would be the sixth soda.

Marginal Cost

The increase in total costs as one more unit is produced.

Marginal Productivity

The additional output obtained by adding an additional unit of a productive resource labor. More precisely, marginal productivity is the change in total output divided by change in the amount of the productive resource employed. $\text{Marginal productivity} = \frac{\text{change in total output}}{\text{change in amount of productive resource}}$

Marginal Propensity to Consume (MPC)

The percentage of new or added income that is consumed.

Marginal Propensity to Save (MPS)

The percentage of new or added income that is saved.

Marginal Revenue

The addition to total revenue as one additional unit is produced and sold.

Marginal Tax Rate

The tax rate charged on the taxpayers last dollar earned; in a progressive tax system marginal tax rate is always greater than the average tax rate.

Market

A network in which buyers and sellers interact to exchange goods and services for money.

Market Clearing Price

A price which rations the supply of a good among competing consumers so that the quantity of the good demanded is equal to the quantity supplied.

Market Economy

A decentralized system where many buyers and sellers interact.

Merchandise Trade Balance

Category in the current account of the balance of payments which includes all trade (manufactured items, agricultural commodities, chemicals and all other physically tangible products).

Microeconomics

The study of the individual parts of the economy, the household and the firm, how prices are determined and how prices determine the production, distribution and use of goods and services.

Minimum Wage

A wage below which employers may not legally pay employees for specific kinds of employment.

Monetarists

Followers of Milton Friedman who focus on the effect of money and monetary policy on changing price and employment levels.

Monetary Base

The total quantity of currency in circulation outside of banks plus the currency held or deposited with the Fed.

Monetary Policy

The federal governments attempt to change aggregate demand through money supply changes.

Money

The accepted common medium of exchange for goods and services in the marketplace functions as the unit of account, a means of deferred payment and a store of value.

Money Market Mutual Funds

Shares in institutional funds invested in financial instruments such as the US Treasury securities, certificates of deposit in financial institutions (CDs) and commercial paper (big corporations).

Money Multiplier

The process by which excess reserves create new demand deposits or money; for example, with a 10% legal reserve requirement, \$10 of excess reserves may be used to create new money.

Money Supply

Legal currency and various transaction account balances held at financial institutions plus small savings and time deposit accounts of individuals (M2).

Monopolistic Competition

A market with a large number of firms selling similar but differentiated products with significant barriers to entry.

Monopoly

A market with only one supplier.

Multiplier

The number of times new investment spending will be required to produce a certain new income.

N**Natural Monopoly**

One producer supplying all of the market at lower costs than many producers could.

Natural Unemployment Rate

An economy's civilian unemployment rate when supply and demand for labor are in equilibrium. The natural rate is the percentage of the civilian labor force unemployed at one time or another during any given year multiplied by the average time people spend searching for jobs.

Near-Monies

Assets which are not directly exchangeable for goods and services but which may be converted into money. A savings account is an example.

Need

A specific quantity of a specific good for which an individual would pay any price.

Net Worth

The difference between the assets and liabilities of a person or business.

New Classical Macroeconomics

See Supply-Side Economics.

New Deal

Programs initiated in the 1930s that were characterized by significantly increased government aid to various economic groups and equally significant increases in government involvement in the economy.

New Economy

Sectors of the economy that are knowledge/human-capital-based with the understanding that technology ultimately derives from human ingenuity. While human capital is a prime factor in the information technology and telecommunications sectors, it also has been responsible for significant improvements in productivity in more traditional industries such as automobiles, aircraft and agriculture.

Nominal GNP

GNP measured in current prices (see Real GNP).

Nominal Interest Rate

The cost inflicted by inflation eroding the value of stored dollars plus the forgone real interest rate; the opportunity cost of holding money.

Normative Economics

Analysis that contains value judgments, either implicitly or explicitly (see Economics; Positive Economics).

O**Oligopoly**

A market structure with just a few firms controlling a high percentage of total sales.

Open Market Operations

The purchase or sale of government bonds by the Federal Reserve in order to change commercial banks' reserves.

Opportunity Cost

The highest-valued sacrifice needed to get a good or service.

Option

Anything that anyone wants. In economics, options (alternatives) are also called goods.

Organization of Petroleum Exporting Countries (OPEC)

A group of nations that produce most of the world's oil and control most of the world's oil exports.

P**Paradox of Thrift**

Increased saving increases withdrawals from the money flow; unless these withdrawals are successfully channeled into new investment spending, capital formation will decline.

Peak

The highest point attained in the business cycle.

Personal Saving

The difference between household income (after taxes) and consumption expenditures.

Political Economy

Policies that emphasize the interaction between politics and economics and that have both political and economic effects.

Price

The amount of money, or other goods, that you have to give up to buy a good or service.

Price Ceiling

The upper legal limit on a price.

Price Elasticity of Demand

A measure of the responsiveness of the quantity demanded of a good to changes in the good's price.

Price Floor

The lower limit imposed on a product's price by a price control law.

Private Good

A good exclusively owned that cannot be simultaneously used by others.

Production Possibilities Curve

All combinations of the maximum amounts of goods that a society can produce with available resources and technology.

Productive Resources

The inputs of labor, natural resources and capital used to generate new goods and services.

Profits

The excess of income over all costs, including the interest cost of the wealth invested. Net income of a business is not an accurate measure of its profit.

Property Rights

The conditions of ownership of an asset, the rights to own, use and sell.

Public Goods

Goods that cannot be withheld from people even if they don't pay for them.

Pure Competition

A situation where many sellers sell the same product and no seller can set the price.

Q**Quota**

A quantitative restriction on imports.

R**Rational Expectations**

Market participants intuitively anticipate systemic policy actions and their consequences for the economy; thus, on average, private market forecasts are accurate and planned inflation is ineffectual (see New Classical Macroeconomics).

Real GNP

The GNP of any year measured in the prices of a base year. Real GNP is nominal GNP adjusted for inflation.

Real Rate of Interest

The dollar interest rate corrected for inflation; equal to the nominal rate minus the inflation rate.

Real Wage

One's wage adjusted for inflation.

Regressive Taxes

A greater portion of income is taken from those in lower levels than from those in upper income levels.

Rent Controls

Fixed limits on rents that can be charged to tenants by owners according to a legal restriction.

Retained Earnings

Business profits which are held by firms and not paid to the stockholders of the firm; earnings are usually reinvested by the firms.

Revenues

Total gross earnings of a firm before subtracting costs.

Right-to-Work Laws

Laws banning union membership as a requirement for continued employment.

S**Scarce Good**

A good which people want more of and which is costly to obtain.

Scarcity Shortage

A term used when the quantity of a good demanded exceeds the quantity supplied at an existing price.

Short Run

The period during which some inputs are fixed and cannot be varied.

Social Costs

Private costs plus external costs.

Socialism

The view that the government should own and control major industries using the resources earned to provide benefits to citizens.

Specialization

The act of producing more of a good than one consumes, the rest of that good being exchanged.

Stagflation

An economic condition characterized by simultaneous inflation, slow growth and high unemployment.

Structural Unemployment

Workers without jobs whose skills are no longer suitable for or do not match the types of jobs available.

Substitutes

Price change for one product leads to a shift in the same direction in the demand for the other product. Supply Curve: A graphic representation of the relationship between quantities supplied at each price for a given time period.

Supply-Side Economics

Focus on the effects of national output potential or supply through reduction of tax government regulation for businesses designed to increase productivity and economic growth.

Surplus

A term used when the quantity of a good supplied exceeds the quantity demanded at existing price.

T**Tariff**

A tax on imports.

Technological Change

An advance, usually scientific, that causes an increase in output to occur relative to quantity of inputs.

Trade-Off

The opportunity costs of selecting one alternative rather than another.

Terms of Trade

The relative prices of goods and services traded in international markets.

Time Deposits

Savings held in the financial institution for a fixed time period (such as six months or

Transaction Costs

The full costs of making an exchange.

Trough

A point in the business cycle corresponding to the end of the slowdown and the beginning of expansion.

V**Variable Costs**

Costs of a production process that increase or decrease along with changes in level of production, as opposed to fixed costs.

Voluntary Export Restraint

Identical to an import quota except that the foreign market agrees voluntarily to limit exports from its country to a market.

W**Waste**

When the relative value of a good is different from that good's marginal cost of production, waste occurs. Goods or resources are wasted when they are allocated to uses which are not the most valuable.

Wealth

The value of the existing stock of goods; those goods may be tangible or intangible.

Wholesale Price Index

A measure of changes in the prices of goods at the wholesale level, particularly those sold between businesses.

Working Poor

Workers earning inadequate income as judged by government-established standard poverty.

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