Glossary

A

Absolute advantage
When one country can use fewer resources to produce a good compared to another country; when a country is more productive compared to another country

Accounting profit
Total revenues minus explicit costs, cincluding depreciation

Acquisition
When one firm purchases another

Actual rate of return
The total rate of return, including capital gains and interest paid on an investment at the end of a time period

Adaptive expectations
The theory that people look at past experience and gradually adapt their beliefs and behavior as circumstances change

Additional external cost
Additional costs incurred by third parties outside the production process when a unit of output is produced

Adjustable-rate mortgage (ARM)
A loan whose interest rate varies with market interest rates and is used by a borrower to purchase a home

Adverse selection
When groups with inherently higher risks than the average person seek out insurance, thus straining the insurance system

Affirmative action
Active efforts by government or businesses that give special rights to minorities in hiring, promotion, or access to education to make up for past discrimination

Aggregate demand (AD)
The amount of total spending on domestic goods and services in an economy

Aggregate demand (*AD*) curve
Curve that shows the total spending on domestic goods and services at each price level

Aggregate demand/aggregate supply (AD/AS) model
A model that shows what determines total supply and total demand for an economy and how total demand and total supply interact at the macroeconomic level

Aggregate production function
The process by which an economy as a whole turns economic inputs—such as human capital, physical capital, and technology—into output, measured as GDP per capita

Aggregate supply (AS)
The total quantity of output firms will produce and sell

Aggregate supply (*AS*) curve
Curve showing the total quantity of output that firms will produce and sell at each price level

Allocative efficiency
When the mix of goods produced represents the mix that society most desires; the quantity where the marginal benefit to society of one more unit equals the marginal cost

Antidumping laws
Laws that block imports sold below the cost of production and impose tariffs that increase the price of these imports to reflect their cost of production

Antitrust laws
Laws that give government the power to block certain mergers and, in some cases, break up large firms into smaller ones

Appreciating
When a currency is worth more in terms of other currencies; also called strengthening

Arbitrage
The process of buying and selling currencies across different markets to take advantage of different interest or exchange rates

Asset
Item of value that a firm or an individual owns

Asset-liability time mismatch
Customers can withdraw a bank's liabilities in the short term but repay its assets in the long term

Asymmetric information
A situation where the seller or the buyer has more information than the other regarding the quality of the item for sale

Automatic stabilizers
Programs that are already laws that stimulate aggregate demand in a recession and hold down aggregate demand in a potentially inflationary boom

Average profit
Profit divided by the quantity of output produced; also known as profit margin

Average total cost
Total cost divided by the quantity of output

Average variable cost
Variable cost divided by the quantity of output

B

Balanced budget
When federal government spending and taxes received are equal

Balance of trade (trade balance)
The gap between exports and imports

Balance sheet
An accounting tool that lists assets and liabilities

Bank capital
A bank's net worth

Bank run
When depositors rush to the bank to withdraw their deposits because they fear the bank may become insolvent

Barriers to entry
The legal, technological, or market forces that may discourage or prevent potential competitors from entering a market

Barter
Trading one good or service for another without using money

Base year
Arbitrary year whose value is 100

Basic quantity equation of money
money supply × velocity = nominal GDP = price level × real GDP

Basket of goods and services
A hypothetical group of different items, with specified quantities of each one, meant to represent a typical set of consumer purchases and used as a basis for calculating how the price level changes over time

Behavioral economics
A branch of economics that seeks to enrich the understanding of decision-making by integrating the insights of psychology and by investigating how given dollar amounts can mean different things to individuals depending on the situation

Bilateral monopoly
A labor market with a monopsony on the demand side and a union on the supply side

Bond
A financial contract through which a borrower like a corporation, city, state, or federal government agrees to repay the amount that it borrowed and also a rate of interest over a period of time in the future

Bondholder
Someone who owns bonds and receives the interest payments

Bond yield
The rate of return a bond is expected to pay at the time of purchase

Break-even point
Level of output where the marginal cost curve intersects the average cost curve at the minimum point of the *AC*; if the price is at this point, the firm is earning zero economic profits

Budget constraint (or budget line)
Shows the possible combinations of two goods that are affordable given a consumer's limited income

Budget deficit
When the federal government spends more money than it receives in taxes in a given year

Budget surplus
When the federal government receives more money in taxes than it spends in a given year

Bundling
A situation in which multiple products are sold as one

Business cycle
The economy's movement from peak to trough and trough to peak

C

Capital deepening
An increase in the average level of physical and/or human capital per person by society

Capital gain
A financial gain from buying an asset, like a share of stock or a house, and later selling it at a higher price

Cartel
A group of firms that collude to produce the monopoly output and sell at the monopoly price

Central bank
An institution that conducts a country's monetary policy and regulates its banking system

Certificate of deposit (CD)
Account that the depositor has committed to leaving in the bank for a certain period of time in exchange for a higher interest rate; also called time deposit

Ceteris paribus
Other things being equal

Checkable deposit
Deposit in a bank that is available by making a cash withdrawal or writing a check; also called a demand deposit

Checking account
A bank account that typically pays little or no interest gives easy access to money, either by writing a check or by using a debit card

Circular flow diagram
A diagram that views the economy as consisting of households and firms interacting in a goods and services market and a labor market

Coins and currency in circulation
The coins and bills that circulate in an economy that are not held by the U.S. Treasury, at the Federal Reserve Bank, or in bank vaults

Coinsurance
When an insurance policyholder pays a percentage of a loss, and the insurance company pays the remaining cost

Collateral
Something valuable—often property or equipment—that a lender would have a right to seize and sell if the borrower does not repay the loan

Collective bargaining
Negotiations between unions and a firm or firms

Collusion
When firms act together to reduce output and keep prices high

Command-and-control regulation
Laws that specify allowable quantities of pollution and that also may detail which pollution-control technologies one must use

Command economy
An economy where economic decisions are passed down from government authority and where the government owns the resources

Commodity-backed currencies
Dollar bills or other currencies with values backed up by gold or another commodity

Commodity money
An item that is used as money but also has value from its use as something other than money

Common market
Economic agreement between countries to allow free trade in goods, services, labor, and financial capital between members while having a common external trade policy

Common resources
Goods that are nonexcludable and rivalrous in consumption

Comparative advantage
When a country can produce a good at a lower cost in terms of other goods; or, when a country has a lower opportunity cost of production

Complements
Goods that are often used together so that consumption of one good tends to enhance consumption of the other

Compound growth rate
The rate of growth when multiplied by a base that includes past GDP growth

Compound interest
An interest rate calculation on the principal plus the accumulated interest

Concentration ratio
An early tool to measure the degree of monopoly power in an industry; measures what share of the total sales in the industry are accounted for by the largest firms, typically the top four to eight firms

Constant-cost industry
As demand increases, the cost of production for firms stays the same

Constant returns to scale
Expanding all inputs proportionately does not change the average cost of production

Constant unitary elasticity
When a given percent change in price leads to an equal percentage change in quantity demanded or supplied

Consumer equilibrium
Point on the budget line where the consumer gets the most satisfaction; this occurs when the ratio of the prices of goods is equal to the ratio of the marginal utilities

Consumer price index (CPI)
A measure of inflation that U.S. government statisticians calculate based on the price level from a fixed basket of goods and services that represents the average consumer's purchases

Consumer surplus
The extra benefit consumers receive from buying a good or service, measured by what the individuals would have been willing to pay minus the amount that they actually paid

Contractionary fiscal policy
Tax increases and/or cuts in government spending designed to decrease aggregate demand and reduce inflationary pressures

Contractionary monetary policy
Monetary policy that reduces the supply of money and the quantity of loans

Contractual rights
Based on property rights, contractual rights allow individuals to enter into agreements with others regarding the use of their property and seek recourse through the legal system in case of noncompliance

Convergence
A pattern in which countries with low per capita incomes grow faster than countries with high per capita incomes, with the possibility of the low-income countries eventually catching up with the high-income countries

Converging economy
Economy of a country that has demonstrated the ability to catch up to the technology leaders by investing in both physical and human capital

Coordination argument
Downward wage and price flexibility requires perfect information about the level of lower wages acceptable to workers

Copayment
When an insurance policyholder must pay a small amount for each service before insurance covers the rest

Copyright
A form of legal protection to prevent copying, for commercial purposes, original works of authorship, including books and music

Core inflation index
A measure of inflation typically calculated by excluding volatile economic variables, such as food and energy, from the CPI to better measure the underlying and persistent trend in long-term prices

Corporate bond
A bond issued by firms that wish to borrow money

Corporate governance
The name economists give to the institutions that are supposed to watch over top executives in companies that shareholders own

Corporate income tax
A tax businesses pay based on their profits

Corporation
A business owned by shareholders who have limited liability for the company's debt yet a share of the company's profits; may be private or public and may or may not have publicly traded stock

Cosigner
Another person or firm who legally pledges to repay some or all of the money on a loan if the original borrower does not

Cost-of-living adjustments (COLAs)
A contractual provision that wage increases will keep up with inflation

Cost-plus regulation
When regulators permit a regulated firm to cover its costs and to make a normal level of profit

Coupon rate
The interest rate paid on a bond; can be annual or semiannual

Countercyclical
Moving in the opposite direction of the business cycle of economic downturns and upswings

Credit card
A card to make purchases with that gives an instruction to immediately transfer money from the credit card company's checking account to the seller; at the end of the month, the user owes the money to the credit card company; a short-term loan

Cross-price elasticity of demand
The percentage change in the quantity of Good A that is demanded as a result of a percentage change in the price of Good B

Crowding out
When federal spending and borrowing cause interest rates to rise and business investment to fall

Current account balance
A broad measure of the balance of trade that includes trade of goods and services, international flows of income, and foreign aid

Cyclically adjusted budget (or **standardized employment budget)**
The budget deficit or surplus in any given year, adjusted for what it would have been if the economy was producing at potential GDP

Cyclical unemployment
The variation in unemployment that results from the economy moving from expansion to recession or from recession to expansion

D

Deadweight loss
The loss in social surplus that occurs when a market produces an inefficient quantity

Debit card
A card that lets the person make purchases, and the financial institution immediately deducts the cost from that person's checking account

Decreasing-cost industry
As demand increases, the cost of production for firms decreases

Deductible
An amount that the insurance policyholders must pay out of their own pocket before the insurance coverage pays anything

Deflation
Negative inflation, which occurs when most of the prices in the economy are falling

Demand
The relationship between price and the quantity demanded of a certain good or service

Demand curve
A graphic representation of the relationship between price and quantity demanded of a certain good or service, with quantity on the horizontal axis and price on the vertical axis

Demand schedule
A table that shows a range of prices for a certain good or service and the quantity demanded at each price

Deposit insurance
Insurance system that makes sure depositors in a bank do not lose their money, at least up to a certain amount, if the bank goes bankrupt

Depreciating
When a currency is worth less in terms of other currencies; also called weakening

Depreciation
The process by which capital ages and loses value

Depression
An especially lengthy and deep recession

Deregulation
Removing government controls over setting prices and quantities in certain industries

Derived demand
Demand for labor is based on demand for the good or service that is produced

Differentiated product
A product that consumers perceive as distinctive in some way

Diminishing marginal utility
The common pattern that each marginal unit of a good consumed provides less additional utility than the previous unit

Discount rate
The interest rate charged by the central bank on the loans that it gives to other commercial banks

Discouraged workers
Those who have stopped looking for employment due to the lack of suitable positions available

Discretionary fiscal policy
When the government passes a new law that explicitly changes tax or spending levels

Discrimination
Actions based on the belief that members of a certain group or groups are in some way inferior solely because of a factor such as race, gender, or religion

Diseconomies of scale
The long-run average cost of producing output increases as total output increases

Disposable income
Income after taxes

Disruptive market change
Innovative new product or production technology which disrupts the status quo in a market, leading the innovators to earn more income and profits and the other firms to lose income and profits, unless they can come up with their own innovations

Diversification
Making loans or investments with a variety of firms to reduce the risk of being adversely affected by events at one or a few firms

Dividend
A direct payment from a firm to its shareholders

Division of labor
The way in which different workers divide required tasks to produce a good or service

Dollarize
When a foreign country uses the U.S. dollar as its currency

Dominant strategy
The strategy an individual (or firm) will pursue regardless of the other individual's (or firm's) decision

Double coincidence of wants
A situation in which two people each want some good or service that the other person can provide

Double counting
Counting output more than once as it travels through the production stages

Dumping
Selling internationally traded goods below their cost of production

Duopoly
An oligopoly with only two firms

Durable goods
Long-lasting goods, like cars and computers

E

Economic profit
Total revenues minus total costs (explicit plus implicit costs)

Economics
The study of how humans make choices under conditions of scarcity

Economic surplus
See *social surplus*

Economic union
Economic agreement between countries to allow free trade between members, a common external trade policy, and coordinated monetary and fiscal policies

Economies of scale
The long-run average cost of producing output decreases as total output increases

Effective income tax
Percentage of total taxes paid divided by total income

Efficiency
When the economy is getting as much benefit as possible from its scarce resources and all the possible gains from trade have been achieved

Elastic demand
When the elasticity of demand is greater than one, indicating a high responsiveness of quantity demanded or supplied to changes in price

Elasticity
An economic concept that measures responsiveness of one variable to changes in another variable

Elasticity of savings
The percentage change in the quantity of savings divided by the percentage change in interest rates

Elastic supply
When the elasticity of supply is greater than one, indicating a high responsiveness of quantity demanded or supplied to changes in price

Employed
Those who are currently working for pay

Employment cost index
A measure of inflation based on wages paid in the labor market

Entry
The long-run process of firms entering an industry in response to industry profits

Equilibrium
The situation where quantity demanded is equal to quantity supplied; the combination of price and quantity where there is no economic pressure from surpluses or shortages that would cause price or quantity to change

Equilibrium in the labor market
Price and quantity where quantity demanded of labor equals the quantity supplied of labor

Equilibrium price
The price where quantity demanded is equal to quantity supplied

Equilibrium quantity
The quantity at which quantity demanded and quantity supplied are equal for a certain price level

Equity
The monetary value a homeowner would have after selling the house and repaying any outstanding bank loans used to buy the house

Estate and gift tax
A type of tax that is placed on people who leave large amounts of assets and/or gifts to the next generation

Excess demand
At the existing price, the quantity demanded exceeds the quantity supplied; also called a shortage

Excess reserves
Reserves banks hold that exceed the legally mandated limit

Excess supply
At the existing price, quantity supplied exceeds the quantity demanded; also called a surplus

Exchange rate
The value of one currency in terms of another currency

Excise tax
A tax on a particular good, such as gasoline, tobacco, or alcohol

Exclusive dealing
An agreement that a dealer will sell products from only one manufacturer

Exit
The long-run process of firms reducing production and shutting down in response to industry losses

Expansionary fiscal policy
Tax cuts and/or increases in government spending designed to stimulate aggregate demand and move the economy out of a recession

Expansionary monetary policy
Monetary policy that increases the supply of money and the quantity of loans

Expected rate of return
How much a project or investment is expected to return to the investor, either in future interest payments, capital gains, or increased profitability

Expenditure multiplier
Keynesian concept that asserts that a change in autonomous spending causes a more-than-proportionate change in real GDP

Explicit costs
Out-of-pocket costs for a firm, for example, payments for wages and salaries, rent, or materials

Exports
Domestically produced goods and services that a country sells abroad

Externality
A market exchange that affects a third party who is outside, or external, to the exchange; sometimes called a spillover

F

Face value
The amount that the bond issuer or borrower agrees to pay the investor

Factor payments
What the firm pays for using the factors of production

Factors of production
The resources such as labor, materials, and machinery that are used to produce goods and services; also called inputs

Federal funds rate
The interest rate at which one bank lends funds to another bank overnight

Fee-for-service
When medical care providers are paid according to the services they provide

Fiat money
Money that has no intrinsic value but is declared by a government to be the country's legal tender

Final goods and services
Goods at the end of the chain of production that are sold for consumption, investment, government, and trade purposes

Financial capital
Money supplied by savers and demanded by borrowers in financial markets

Financial intermediary
An institution, like a bank, that receives money from savers and provides funds to borrowers

Firm
An organization that combines inputs of labor, capital, land, and raw or finished component materials to produce outputs

First rule of labor markets
An employer will never pay a worker more than the value of the worker's marginal productivity to the firm

Fiscal policy
Economic policies that involve government spending and taxes

Fixed cost
Cost of the fixed inputs; expenditure that a firm must make before production starts and that does not change regardless of the production level

Fixed inputs
Factors of production that can't be easily increased or decreased in a short period of time

Floating exchange rate
An exchange rate determined by the foreign exchange market

Foreign direct investment (FDI)
Purchasing more than 10% of a firm or starting a new enterprise in another country

Foreign exchange market
The market in which people use one currency to buy another currency

Four-firm concentration ratio
The percentage of the total sales in the industry that are accounted for by the largest four firms

Free rider
A person who wants others to pay for the public good and then plans to use the good themselves; if many people act as free riders, the public good may never be provided

Free trade
International trade that is not subject to tariffs, quotas, or any regulations

Free trade agreement
Economic agreement between countries to allow free trade between members

Frictional unemployment
Unemployment that occurs when workers are between jobs

Full-employment GDP
When the economy is producing at its potential and unemployment is at the natural rate of unemployment

Fungible
The idea that units of a good—such as dollars, ounces of gold, or barrels of oil—are capable of mutual substitution with each other and carry equal value to the individual

G

Gains from trade
The additional output a country can consume as a result of specialization and trade

Game theory
A branch of mathematics that economists use to analyze situations in which players must make decisions and then receive payoffs based on what decisions the other players make

GDP deflator
A price index measuring the average prices of all final goods and services included in the economy

GDP per capita
GDP divided by population

Globalization
The trend in which buying and selling in markets have increasingly crossed national borders

Goods and services market
A market in which firms are sellers of what they produce and households are buyers

Gross domestic product (GDP)
The value of all final goods and services produced within a country in a given year

Gross national product (GNP)
The value of all final goods and services produced by a country's residents, wherever located, in a given year

H

Hard peg
An exchange rate policy in which the central bank sets a fixed and unchanging value for the exchange rate

Health maintenance organization (HMO)
An organization that provides health care and is paid a fixed amount per person enrolled in the plan, regardless of how many services are provided

Hedge
Using a financial transaction as protection against an investment risk

Herfindahl-Hirschman Index (HHI)
Approach to measuring market concentration by adding the square of the market share of each firm in the industry

High-yield bonds
Bonds that offer relatively high interest rates to compensate for their relatively high chance of default; also called junk bonds

Human capital
The accumulated skills and education of workers

Human capital per person
The amount of knowledge, experience, or skills available to help a person produce a good or service

Hyperinflation
An outburst of high inflation that often occurs when economies shift from a controlled economy to a market-oriented economy

I

Imperfect information
A situation where either the buyer, seller, or both are uncertain about the qualities of what they are buying and selling

Imperfectly competitive
Firms and organizations that fall between the extremes of monopoly and perfect competition

Implementation lag
The time it takes for fiscal policy funds to be dispersed to the appropriate agencies to implement the programs

Implicit costs
Opportunity cost of resources already owned by the firm and used in business, for example, expanding a factory onto land already owned

Import quotas
Numerical limits on the quantity of products that a country can import

Imports
Goods and services that are produced abroad and purchased domestically

Income
A flow of money received, often measured on a monthly or an annual basis

Income effect
A higher price means that, in effect, the buying power of income has been reduced, even though actual income has not changed; always happens simultaneously with a substitution effect

Income inequality
When one group receives a disproportionate share of total income or wealth than others

Increasing-cost industry
As demand increases, the cost of production for firms increases

Indexed
A wage, price, or interest rate that is automatically adjusted for inflation

Index fund
A mutual fund that seeks only to mimic the market's overall performance

Index number
A unit-free number derived from the price level over a number of years, which makes computing inflation rates easier; has a value around 100

Indifference curve
A graphic representation of the combinations of two goods that provide an equal level of utility for an individual

Individual income tax
A tax based on all forms of income received by individuals

Inelastic demand
When the elasticity of demand is less than one, indicating that a one percent increase in price paid by the consumer leads to less than a one percent change in purchases (and vice versa); this indicates a low responsiveness by consumers to price changes

Inelastic supply
When the elasticity of supply is less than one, indicating that a one percent increase in price paid to the firm will result in a less than one percent increase in production by the firm; this indicates a low responsiveness of the firm to price increases (and vice versa if prices drop)

Infant industry argument
Argument to protect new industries by blocking imports for a limited time to give the infant industry time to mature before it starts competing on equal terms in the global economy

Inferior good
A good in which the quantity demanded falls as income rises, and in which quantity demanded rises as income falls; a good that has a negative income elasticity of demand

Infinite elasticity
The extremely elastic situation of demand or supply where quantity changes by an infinite amount in response to any change in price; horizontal in appearance

Inflation
A sustained increase in the overall level of prices

Inflationary gap
Equilibrium at an output level above potential GDP

Inflation targeting
A rule that the central bank is required to focus only on keeping inflation low

Infrastructure
A component of physical capital, such as roads and rail systems

Initial public offering (IPO)
The first sale of shares of stock by a firm to outside investors

Innovation
Putting advances in knowledge to work in a new product or service

Inputs
The resources such as labor, materials, and machinery that are used to produce goods and services; also called factors of production

Insurance
Method of protecting a person from financial loss, whereby policyholders make regular payments to an insurance entity; the insurance firm then remunerates a group member who suffers significant financial damage from an event covered by the policy

Intellectual property
The body of law including patents, trademarks, copyrights, and trade secret law that protects the right of inventors to produce and sell their inventions

Interest rate
The "price" of borrowing in the financial market; a rate of return on investment

Intermediate goods
Goods that are part of production for other goods

Intermediate zone
Portion of the *SRAS* curve where GDP is below potential but not so far below as in the Keynesian zone; the curve is upward-sloping but not vertical

International capital flows
Flow of financial capital across national boundaries, either as portfolio or direct investment

International externalities
Externalities that cross national borders and that a single nation acting alone cannot resolve

International price index
A measure of inflation based on the price of merchandise that is exported or imported

Intertemporal choices
Choices that are made over time

Intertemporal decision-making
Making decisions over time

Intra-industry trade
International trade of goods within the same industry

Invention
Advances in knowledge

Inventories
Goods that have been produced but not yet sold

Invisible hand
Adam Smith's concept that individuals' self-interested behavior can lead to positive social outcomes

J

Junk bonds
See *high-yield bonds*

K

Keynesian zone
Portion of the *SRAS* curve where GDP is far below potential and the curve is flat

Keynes' law
Demand creates its own supply

Kinked demand curve
A perceived demand curve that arises when competing oligopoly firms commit to match price cuts but not price increases

L

Labor force
Those who are employed and those who are unemployed but actively looking for work

Labor force participation rate
The percentage of adults in an economy who are either employed or who are unemployed and looking for a job

Labor market
The market in which households sell their labor as workers to business firms or other employers

Labor productivity
The value of what is produced per worker or per hour worked

Law of demand
The common relationship that a higher price leads to a lower quantity demanded of a certain good or service and a lower price leads to a higher quantity demanded, while all other variables are held constant

Law of diminishing marginal productivity
General rule that as a firm employs more labor, eventually the amount of additional output produced declines

Law of diminishing marginal utility
The common pattern that each marginal unit of a good consumed provides less additional utility than the previous unit

Law of diminishing returns
As additional increments of resources are added to producing a good or service, the marginal benefit from those additional increments will decline

Law of supply
The common relationship that a higher price leads to a greater quantity supplied and a lower price leads to a lower quantity supplied, while all other variables are held constant

Legal monopoly
Legal prohibitions against competition, such as regulated monopolies and intellectual property protection

Legislative lag
The time it takes to get a fiscal policy bill passed

Lender of last resort
An institution that provides short-term emergency loans to banks and other financial institutions during financial crises

Liability
Any debt or amount that a firm or an individual owes

Liquidity
How quickly a financial asset can be converted into a medium of exchange used to buy a good or service

Living wage
A wage that will ensure a reasonable standard of living

Logrolling
The situation in which groups of legislators all agree to vote for a package of otherwise unrelated laws that they individually favor

Long run
Period of time during which all of a firm's inputs are variable

Long-run aggregate supply (*LRAS*) curve
Vertical line at potential GDP showing no relationship between the price level for output and real GDP in the long run

Long-run average cost (*LRAC*) curve
Shows the lowest possible average cost of production, allowing all the inputs to production to vary so that the firm is choosing its production technology

Long-run equilibrium
Where all firms earn zero economic profits producing the output level where $P = MR = MC$ and $P = AC$

Loose monetary policy
See *expansionary monetary policy*

Lorenz curve
A graph that compares the cumulative income actually received to a perfectly equal distribution of income; it shows the share of population on the horizontal axis and the cumulative percentage of total income received on the vertical axis

M

M1 money supply
A narrow definition of the money supply that includes currency in circulation, demand deposits, and traveler's checks

M2 money supply
A definition of the money supply that includes everything in M1 but also adds savings deposits, money market funds, and certificates of deposit

Macroeconomic externality
Occurs when what happens at the macro level is different from and inferior to what happens at the micro level

Macroeconomics
The branch of economics that focuses on broad issues such as growth, unemployment, inflation, and the trade balance

Marginal analysis
The examination of decisions on the margin, meaning a little more or a little less from the status quo

Marginal cost
The additional cost of producing one more unit; mathematically, $MC = \Delta TC/\Delta Q$

Marginal cost of labor
The additional cost to a firm when it hires one more worker

Marginal product of labor
The change in a firm's output when it employees more labor; mathematically, $MP = \Delta TP/\Delta L$

Marginal rate of subsitution
The rate at which an individual is willing to trade a good for another to keep utility constant; the slope of the indifference curve at a given point

Marginal revenue
The additional revenue gained from selling one more unit

Marginal tax rates
A tax due on all yearly income

Marginal utility
The additional utility provided by one additional unit of consumption

Marginal utility per dollar
The additional satisfaction gained from purchasing a good given the price of the product; *MU*/price

Market
Interaction between potential buyers and sellers; a combination of demand and supply

Marketable permit program
A permit that allows a firm to emit a certain amount of pollution; firms with more permits than pollution can sell the remaining permits to other firms

Market economy
An economy where economic decisions are decentralized, private individuals own resources, and businesses supply goods and services based on demand

Market failure
When the market on its own does not allocate resources efficiently in a way that balances social costs and benefits; externalities are one example of a market failure

Market share
The percentage of total sales a firm has in a market

Market structure
The conditions in an industry, such as number of sellers, how easy or difficult it is for a new firm to enter, and the types of products that are sold

Maturity date
The date that a borrower must repay a bond by

Median voter theory
The theory that politicians will try to match policies to what pleases the median voter preferences

Medium of exchange
Whatever is widely accepted as a method of payment between buyer and seller

Menu costs
Costs firms face when changing prices

Merchandise trade balance
A balance of trade that only measures trade of physical goods

Merged currency
When a nation chooses to use another nation's currency as its own

Merger
When two formerly separate firms combine to become a single firm

Microeconomics
The branch of economics that focuses on actions of particular agents within the economy, like households, workers, and business firms

Minimum resale price maintenance agreement
An agreement that requires a dealer who buys from a manufacturer to sell for at least a certain minimum price

Minimum wage
A price floor that makes it illegal for an employer to pay employees less than a certain hourly rate

Model
See *theory*

Monetary policy
Economic policies that involve altering the level of interest rates, the availability of credit in the economy, and the extent of borrowing

Money-back guarantee
A promise that the seller will refund the buyer's money under certain conditions

Money market fund
The deposits of many investors that are pooled together and invested in safe assets, like short-term government bonds

Money multiplier
Determines how many times a loan will be multiplied as it is spent in the economy and then redeposited in other banks; the reciprocal of the reserve requirement

Monopolistic competition
Many firms competing to sell similar but differentiated products

Monopoly
A situation in which one firm produces all of the output in a market

Monopsony
A labor market where there is only one employer

Moral hazard
When people have insurance against a certain event, they are less likely to guard against that event occurring

Municipal bond
A bond issued by cities that wish to borrow money

Mutual funds
Funds that buy a range of stocks or bonds from different companies, thus allowing an investor an easy way to diversify

N

National debt
The total accumulated amount that the government has borrowed over time and not yet paid back

National income
All income to businesses and people that is generated in GDP

National interest argument
The argument that a nation should not depend too heavily on another nation for key imports

National saving
The total of a nation's domestic saving by households and companies (private saving), and the government (public saving)

National saving and investment identity
The quantity of financial capital supplied in an economy must equal the quantity of financial capital demanded

Natural monopoly
Economic conditions in an industry, such as economies of scale or control of a critical resource, that limit effective competition

Natural rate of unemployment
The baseline level of unemployment that occurs even if the economy is producing at potential (or full-employment) GDP

Near-poor
Those who have incomes just above the poverty line

Negative externality
Harmful spillovers to a third party or parties who did not purchase the good or service that provided the externalities

Neoclassical economists
Economists who generally emphasize the importance of aggregate supply in determining the size of the economy in the long run

Neoclassical perspective
The philosophy that, in the long run, the business cycle will fluctuate around the potential, or full-employment, level of output

Neoclassical zone
Portion of the *SRAS* curve where GDP is at or near potential output and the curve is steep

Net national product (NNP)
GNP minus the value of physical capital that is worn out or reduced in value because of aging

Net worth
The excess of the value of assets over and above the amount of the liabilities; total assets minus total liabilities

Nominal value
An economic statistic measure with actual prices

Nondurable goods
Short-lived goods, like food and clothing

Nonexcludable
When it is costly or impossible to exclude someone from using the good and thus hard to charge for it

Nonrival
Even when one person uses the good, others can also use it

Nontariff barriers
Ways a nation can draw up rules, regulations, inspections, and paperwork to make it more costly or difficult to import products

Normal good
A good in which the quantity demanded rises as income rises, and in which quantity demanded falls as income falls; a good that has a positive income elasticity of demand

Normative statement
Statement which describes how the world should be

O

Occupational license
Licenses issued by government agencies, which indicate that a worker has completed a certain type of education or passed a certain test

Oligopoly
When a few large firms have all or most of the sales in an industry

Open market operations
In the U.S., refers to the Federal Reserve selling or buying Treasury bonds to influence the quantity of money and the level of interest rates

Opportunity cost
Measures cost by what is given up/forfeited in exchange; measures the value of the forgone alternative

Opportunity set
All possible combinations of consumption an individual can afford given the prices of goods and the individual's income

Out of the labor force
Those who are not working and not looking for work

P

Partnership
A company that is unincorporated and owned by two or more people who are jointly liable for anything done by the business

Patent
A government rule that gives the inventor the exclusive legal right to make, use, or sell an invention for a limited time

Payment system
Helps an economy exchange goods and services for money or other financial assets

Payroll tax
A tax based on pay received from employers; in the U.S., it provides funds for Social Security and Medicare

Peak
The highest point of the economy before a recession begins

Perfect competition
Type of market were each firm faces many competitors that sell identical products

Perfect elasticity
See *infinite elasticity*

Perfect inelasticity
See *zero elasticity*

Perfectly competitive labor market
A labor market where neither suppliers of labor nor demanders of labor have any market power; thus, an employer can hire all the workers they would like at the going market wage

Phillips curve
Curve that shows the tradeoff between unemployment and inflation

Physical capital
The factories and equipment that firms use in production; this includes infrastructure

Physical capital per person
The amount and kind of machinery and equipment available to help a person produce a good or service

Pollution charge
A tax imposed on the quantity of pollution that a firm emits; also called a pollution tax

Pork-barrel spending
Spending that benefits mainly a single political district

Portfolio investment
An investment in another country that is purely financial and does not involve any management responsibility

Positive externality
Beneficial spillovers to a third party or parties who did not purchase the good or service that provided the externalities; also called external benefits

Positive statement
Statement which describes the world as it is

Potential GDP
The maximum quantity that an economy can produce given full employment of its existing levels of labor, physical capital, technology, and institutions

Poverty
The situation of being below a certain level of income one needs for a basic standard of living

Poverty line
The specific amount of income one requires for a basic standard of living

Poverty rate
Percentage of the population living below the poverty line

Poverty trap
A problem that arises from antipoverty programs set up so that government benefits decline substantially as people earn more income; as a result, working provides little financial gain

Predatory pricing
When an existing firm uses sharp but temporary price cuts to discourage new competition

Premium
Payment made to an insurance company

Present value
A bond's current price at a given time

Price
What a buyer pays for a unit of the specific good or service

Price cap regulation
When the regulator sets a price that a firm cannot exceed over the next few years

Price ceiling
A legal maximum price

Price control
Government laws to regulate prices instead of letting market forces determine prices

Price elasticity
The relationship between the percent change in price resulting in a corresponding percentage change in the quantity demanded or supplied

Price elasticity of demand
Percentage change in the quantity demanded of a good or service divided by the percentage change in price; calculated as an absolute value

Price elasticity of supply
Percentage change in the quantity supplied divided by the percentage change in price; calculated as an absolute value

Price floor
A legal minimum price

Price taker
A firm in a perfectly competitive market that must take the prevailing market price as given

Prisoner's dilemma
A game in which the gains from cooperation are larger than the rewards from pursuing self-interest

Private benefits
The benefits a person who consumes a good or service receives or the benefits a company is able to capture from a new product or process

Private company
A firm owned by the people who run it on a day-to-day basis

Private enterprise
System where private individuals or groups of private individuals own and operate the means of production (resources and businesses)

Private rates of return
When the estimated rates of return go primarily to an individual; for example, earning interest on a savings account

Producer price index (PPI)
A measure of inflation based on the prices paid for supplies and inputs by producers of goods and services

Producer surplus
The extra benefit producers receive from selling a good or service, measured by the price the producer actually received minus the price the producer would have been willing to accept

Product differentiation
Any action that firms do to make consumers think their products are different from their competitors'

Production
The process of combining inputs to produce outputs, ideally of a value greater than the value of the inputs

Production function
A mathematical equation that tells how much output a firm can produce with given amounts of the inputs

Production possibilities frontier (PPF)
A diagram that shows the productively efficient combinations of two products that an economy can produce given the resources it has available

Production technologies
Alternative methods of combining inputs to produce output

Productive efficiency
When it is impossible to produce more of one good (or service) without decreasing the quantity produced of another good (or service)

Progressive tax
A tax system in which the rich pay a higher percentage of their income in taxes, rather than a higher absolute amount

Property rights
The legal rights of ownership on which others are not allowed to infringe upon without paying compensation

Proportional tax
A tax that is a flat percentage of income earned, regardless of level of income

Protectionism
Government policies to reduce or block imports

Public company
A firm that has sold stock to the public, which investors can then buy and sell

Public good
Good that is nonexcludable and nonrival and, thus, is difficult for market producers to sell to individual consumers

Purchasing power parity (PPP)
The exchange rate that equalizes the prices of internationally traded goods across countries

Q

Quality/new goods bias
How inflation calculated over time using a fixed basket of goods tends to overstate the true rise in the cost of living because it does not take into account improvements in the quality of existing goods or the invention of new goods

Quantitative easing (QE)
The purchase of long-term government and private mortgage-backed securities by central banks to make credit available in hopes of stimulating aggregate demand

Quantity demanded
The total number of units of a good or service consumers are willing to purchase at a given price

Quantity supplied
The total number of units of a good or service producers are willing to sell at a given price

Quintile
Dividing a group into fifths, a method economists often use to look at distribution of income

R

Race to the bottom
When production locates in countries with the lowest environmental (or other) standards, putting pressure on all countries to reduce their environmental standards

Rational expectations
The theory that people form the most accurate possible expectations about the future that they can, using all information available to them

Rational ignorance
The theory that rational people will not vote if the costs of becoming informed and voting are too high or because they know their vote will not be decisive in the election

Real interest rate
The nominal interest rate minus the inflation rate

Real value
An economic statistic measure adjusted for inflation

Recession
A significant decline in real GDP

Recessionary gap
Equilibrium at an output level below potential GDP

Recognition lag
The time it takes to determine that a recession has occurred

Redistribution
Taking income from those with higher incomes and providing income to those with lower incomes

Regressive tax
A tax in which people with higher incomes pay a smaller share of their income in taxes

Regulatory capture
When the supposedly regulated firms end up playing a large role in setting the regulations that they will follow; as a result, they "capture" the people, usually through the promise of a job in that "regulated" industry once their term in government has ended

Reserve requirement
The percentage amount of its total deposits that a bank is legally obligated to either hold as cash in its vault or on deposit with the central bank

Reserves
Funds that a bank keeps on hand and does not loan out or invest in bonds

Restrictive practices
Practices that reduce competition but do not involve outright agreements between firms to raise prices or to reduce the quantity produced

Ricardian equivalence
The theory that rational private households might shift their saving to offset government saving or borrowing

Risk
A measure of the uncertainty of a project's profitability

Risk group
A group that shares roughly the same risks of an adverse event occurring

Rule of law
The process of enacting laws that protect individual and entity rights to use their property as they see fit; laws must be clear, public, fair, enforced, and applicable to all members of society

S

Safety net
The group of government programs that provide assistance to the poor and the near-poor

Savings account
A bank account that pays an interest rate; withdrawing money typically requires a trip to the bank or an automatic teller machine

Savings deposit
Bank account you cannot withdraw money from by writing a check but can withdraw the money at a bank or transfer it easily to a checking account

Say's law
Supply creates its own demand

Scarcity
When human wants for goods and services exceed the available supply

Service contract
The buyer pays an extra amount, and the seller agrees to fix anything specified in the contract that goes wrong for a set time period

Services
The most common jobs in a modern economy, where no tangible good is produced; jobs in education, health care, and legal and financial services

Shareholders
People who own shares of stock in a firm

Shares
A firm's stock, divided into individual portions

Shift in demand
When a change in some economic factor (other than price) causes a different quantity to be demanded at every price

Shift in supply
When a change in some economic factor (other than price) causes a different quantity to be supplied at every price

Shortage
At the existing price, the quantity demanded exceeds the quantity supplied; also called excess demand

Short run
Period of time during which at least one or more of the firm's inputs is fixed

Short-run aggregate supply (*SRAS*) curve
Positive short-run relationship between the price level for output and real GDP, holding prices of inputs fixed

Short-run average cost (*SRAC*) curve
The average total cost curve in the short term; shows the total of the average fixed costs and the average variable costs

Shutdown point
Level of output where the marginal cost curve intersects the average variable cost curve at the minimum point of the *AVC*; if the price is below this point, the firm should shut down immediately

Simple interest
An interest rate calculation only on the principal amount

Slope
The ratio of rise to run; shows the opportunity cost of choosing one good over another

Smart card
A card that stores a certain amount of money, which can be used to make purchases

Social benefits
The sum of private benefits and positive externalities

Social costs
Costs that include both the private costs incurred by firms and also additional costs incurred by third parties outside the production process, like costs of pollution

Social rate of return
When the estimated rates of return go primarily to society; for example, providing free education

Social surplus
The sum of consumer surplus and producer surplus; also called economic surplus or total surplus

Soft peg
An exchange rate policy in which the government usually allows the foreign exchange market to determine the exchange rate, but the central bank may intervene if the currency is moving rapidly in one direction

Sole proprietorship
A company that is unincorporated, with one owner who is legally liable for anything done by the business

Special economic zone (SEZ)
An area of a country, usually with access to a port, where the government does not tax trade

Special interest groups
Groups that are small in number relative to the nation but are well-organized and, thus, exert a disproportionate effect on political outcomes

Specialization
When workers or firms focus on particular tasks for which they are well-suited within the overall production process

Spillover
See *externality*

Splitting up the value chain
Many of the different stages of producing a good happen in different geographic locations

Stagflation
When an economy experiences high unemployment and inflation at the same time

Standard of deferred payment
If money is usable to make purchases today, it must also be acceptable to make purchases today that will be paid in the future

Standard of living
A measurement that includes all elements that affect people's well-being, whether or not they are bought and sold in the market

State bond
A bond issued by a state that wishes to borrow money

Stock
Represents partial ownership of a specific company

Store of value
Something that serves as a way of preserving economic value that one can spend or consume in the future

Structural unemployment
Unemployment that occurs because workers lack skills valued by the labor market

Structures
A supply-side component of GDP that includes homes, office buildings, shopping malls, and factories

Substitute
A good that can replace another to some extent, so that greater consumption of one good can mean less of the other

Substitution bias
How an inflation rate calculated over time using a fixed basket of goods tends to overstate the true rise in the cost of living because it does not take into account that people can substitute away from goods whose prices rise considerably

Substitution effect
When a price changes, consumers have an incentive to consume less of the good with a relatively higher price and more of the good with a relatively lower price; always happens simultaneously with an income effect

Sunk costs
Costs made in the past that cannot be recovered

Supply
The relationship between price and the quantity supplied of a certain good or service

Supply curve
A graphic representation of the relationship between price and quantity supplied, with quantity on the horizontal axis and price on the vertical axis

Supply schedule
A table that shows a range of prices for a good or service and the quantity supplied at each price

Surplus
At the existing price, quantity supplied exceeds the quantity demanded; also called excess supply

T

T-account
A balance sheet with a two-column format and a *T* shape formed by the vertical line down the middle and the horizontal line under the column headings, "Assets" and "Liabilities"

Tariffs
Taxes that governments place on imported goods and services

Tax incidence
Manner in which the tax burden is divided between buyers and sellers

Technological change
A combination of invention and innovation

Technology
All the advances that make existing inputs produce more, higher quality, different, or new products

Theory
A representation of an object or situation that is simplified while including enough of the key features to help us understand the object or situation

Tight monetary policy
See *contractionary monetary policy*

Total cost
The sum of fixed and variable costs of production

Total product
Synonym for a firm's output

Total revenue
Income from selling a firm's product; defined as price times quantity sold

Total surplus
See *social surplus*

Trade balance
The difference between exports and imports

Trade deficit
When a country's exports are less than its imports

Trademark
An identifying symbol or name for a particular good and can only be used by the firm that registered that trademark

Trade secrets
Methods of production kept secret by the producing firm

Trade surplus
When a country's exports are greater than its imports

Traditional economy
Typically an agricultural economy where things are done the same as they have always been done

Transaction costs
The costs associated with finding a lender or borrower for money

Treasury bond
A bond issued by the federal government through the U.S. Department of the Treasury

Trough
The lowest point of a recession before a recovery begins

Twin deficits
Deficits that occur when a country is running both a trade and budget deficit

Tying sales
A situation where a customer is allowed to buy a product only if the customer also buys another product

U

Underemployed
Those who are trained or skilled for one type of work but are working in a lower-paying job or one that does not utilize their skills

Underground economy
A market where the buyers and sellers make transactions in violation of one or more government regulations

Unemployed
Those who are out of work and actively looking for a job

Unilateral transfers
One-way payments that governments, private entities, or individuals make that they send abroad with nothing received in return

Unitary elasticity
When the calculated elasticity is equal to one, indicating that a change in the price of the good or service results in a proportional change in the quantity demanded or supplied

Unit of account
The common way in which we measure market values in an economy

Usury laws
Laws that impose an upper limit on the interest rate that lenders can charge

Utility
The satisfaction, usefulness, or value one obtains from consuming goods and services

V

Value chain
How a good is produced in stages

Variable cost
The cost of production that increases with the quantity produced; the cost of the variable inputs

Variable inputs
Factors of production that a firm can easily increase or decrease in a short period of time

Velocity
The speed with which money circulates through the economy; calculated as nominal GDP divided by the money supply

Venture capital
Financial investments in new companies that are still relatively small in size but that have potential to grow substantially

Voting cycle
The situation in which a majority prefers *A* over *B*, *A* over *C*, and *C* over *A*

W

Wage
The price in the labor market; also called salary

Wage elasticity of labor supply
The percentage change in hours worked divided by the percentage change in wages

Warranty
A promise to fix or replace the good for a certain period of time

Wealth
The sum of the value of all assets, including money in bank accounts, financial investments, a pension fund, and the value of a home

Z

Zero elasticity
The highly inelastic case of demand or supply in which a percentage change in price, no matter how large, results in zero change in the quantity; vertical in appearance