IMPORTANT TERMS & DEFINITIONS [ECONOMICS]

Microeconomics

1. Introduction to Economics

Scarcity	Situation where limited resources available unable to satisfy unlimited human wants
Opportunity Cost (OC)	Cost of any activity measured in terms of next best alternative forgone
Production Possibility Curve (PPC)	Shows all different maximum attainable combinations of goods & services produced when all available resources are used efficiently at given state of technology
Law of Increasing Opportunity Cost	As more of a good is produced, more of another good has to be sacrificed in production
Comparative Advantage	When one can perform an activity at a lower opportunity cost than anyone else
Law of Comparative Advantage	Trade can benefit countries if they specialize in goods in which they have a comparative advantage

2. Demand & Supply

Law of Demand	Inverse relationship exists between price of good and quantity demanded of good, ceteris paribus
Law of Supply	Direct relationship exists between price of good and quantity supplied of good, ceteris paribus
Price Elasticity of Demand (PED)	Degree of responsiveness of quantity demanded of good to a change in its own price, ceteris paribus
Income Elasticity of Demand (YED)	Degree of responsiveness of demand to a change in income of consumers, ceteris paribus
Cross Elasticity of Demand (XED)	Degree of responsiveness of demand for one product to a change in price of another, ceteris paribus
Price Elasticity of Supply (PES)	Degree of responsiveness of quantity supplied of good to a change in its own price, ceteris paribus
Consumer Surplus (CS)	Excess of price buyers willing and able to pay for good over actual price paid
Producer Surplus (PS)	Excess of what producer willing and able to put up for sale for a good over actual price paid
Deadweight Loss	Loss in welfare not gained by anyone in society
Tax Incidence	Division of tax between consumers & producers
Subsidies	Fixed amount of money given to producers for each unit sold that lowers cost of good
Price Floor (minimum price)	Legally established minimum price above market equilibrium price
Price Ceiling (maximum price)	Legally established maximum price below market equilibrium price
Black Market	Market where sellers ignore government's price restrictions & sell illegally at whatever price equates illegal demand & supply

3. Cost Theory & Size of Firms

Fixed Factor	Factor of production whose quantity cannot be changed in short run to change output
Variable Factor	Factor of production whose quantity can be changed within time period to change output

Short Run	Production period in which there is / are fixed factor(s)
Long Run	Production period in which there are no fixed factors
Law of Diminishing Marginal Returns (LDMR)	As more units of a variable factor are added to an unchanging fixed factor, the marginal product generated by adding the variable factor will eventually decrease
Marginal Cost	Additional cost from additional output
Economies of Scale	Unit costs decrease as scale of production increases
Diseconomies of Scale	Unit costs increase as scale of production increases
Minimum Efficient Scale (MES)	Occurs at where LRAC curve stops falling / lowest point of LRAC curve
Internal Expansion	Expanding productive capacity to enjoy internal EOS
Horizontal Integration	Merger of two firms at same stage of production
Vertical Integration	Merger of two firms at different stages of production
Conglomerate Integration	Combination of two firms of different industries with nothing in common

4. Perfect Competition & Monopoly

Perfect Competition	Market of many buyers and sellers of a homogeneous good
Monopoly	Market of only one seller of a product without substitutes (absence of competition)
Price Taker	A firm that takes the price from the market as given, without ability to influence the price
Price Setter	A firm that has the ability to influence the market price
Productive Efficiency	Occurs when firm is able to produce an output at any point along LRAC curve in long run or least cost at any given period
Allocative Efficiency	Occurs at where output level when price of good equals marginal cost of producing it
Natural Monopoly	When it is cost efficient to have a single firm in the industry such that it has lower AC (substantial EOS) over range of market demand
Predatory Pricing	Selling below cost price to drive out competitors
Cartel	Agreement among existing suppliers to keep out competitors
X-inefficiency	Occurs when a firm becomes complacent and suffers from inefficiency due to lack of competition
Price Discrimination	Charging different prices for the same product or for different units of it when such price differences is not because of cost differences
1st Degree Price Discrimination	Monopolist sells each unit to consumers at maximum price they are willing to pay
2nd Degree Price Discrimination	Monopolist sets uniform price per unit for specific quantity of good and lower price per unit for subsequent units
3rd Degree Price Discrimination	Monopolist charges different prices for the same commodity in different markets

5. Oligopoly & Monopolistic Competition

Oligopoly	Market where few large firms have large market share
Monopolistic Competition	Market where many small firms exist, each providing different products or services
Price Rigidity	Tendency for prevailing market prices to remain stable over a long time
Mutual Interdependence	Each firm affects rival firms' decisions and are also affected by rival firms' decisions

Product Innovation	Differentiation of product in consumer's viewpoint through improvements to product
Process Innovation	Reducing AC without sacrificing profits through streamlining processes
Brand Proliferation	Firms produce many brands to saturate market, leaving no gaps for rivals
Market Segmentation	Segmenting market into sub-markets / market niches with different needs catered through product innovation
Kinked Demand Curve Theory	Explains price rigidity; TR falls when prices rise / fall as rivals will match price decreases but not price increases
Price Wars	Used to eliminate new competitors, when a firm lowers its price, other firms start lowering prices and keep undercutting competitors price
Collusive Oligopoly	When there are tacit / explicit agreements among firms on operations
Cartel Theory	Formal arrangement by sellers to fix prices through manipulating supply to the market
Price Leadership Theory	Oligopolists agree to set same price as price leader in industry, allowing price adjustments without price wars
Dominant Firm Price Leadership	Others in industry follow largest producer in industry in price changes
Barometric Firm Price Leadership	Others in industry follow price changes of producer most sensitive to market conditions
Contestable Market Theory	In a market of free entry & exit, number of firms in industry unimportant since firms always behave as if competition is very strong (no matter number of firms)
Differentiated Product	Product that is slightly different from and yet close substitute to product of other firms in industry
Product Development	Production of good with potentially high demand and different from products of rival firms or provision / improvement of service to better / differ from rivals
Excess Capacity Theorem	Firms inefficient in using society's & own resources, thus not producing at socially ideal output

6. Alternative Theories of the Firm

Profit Satisficing	Where managers of firm make enough profit to satisfy shareholder demands instead of profit maximizing
Managerial Theories	Managers, with discretionary power and freedom to run the firm, maximize their own utility instead of profit
Revenue Maximization	Firms aim to maximize sales revenue instead of profits
Growth Maximization	Firms aim to maximize growth instead of profits
Organizational Slack	Tendency of firms in non-competitive markets to produce at higher than AC (X-Inefficiency)
Nationalization	Industry put under ownership and control of the state
Privatization	Returning state-owned corporations to private sectors, involving transfer of assets from public to private sector

7. Market Failure & Government Intervention

Social Efficiency / Pareto Optimality	Achieved when no one can be made better off without someone being made worse off
External Benefits	Benefits from production / consumption experienced by people other than the producer / consumer (third parties)
External Costs	Costs from production / consumption experienced by people other than the producer / consumer (third parties)

Private Marginal Benefit (PMB) of good	Value the consumer places on last unit of good produced, equal to price and thus represented by demand
Private Marginal Cost (PMC) of good	OC of resources used up in making additional unit of good, represented by supply
Social Marginal Benefit (SMB)	Sum of PMB and External Benefit to represent marginal benefit on society
Social Marginal Cost (SMC)	Sum of SMC and External Cost to represent marginal cost on society
Underproduction	When in the production of the good, SMB > SMC (production can be increased to socially optimum output)
Overproduction	When in the production of the good, SMC > SMB (production can be decreased to socially optimum output)
Market Failure	Free markets, operating without government intervention, fail to deliver socially efficient allocation of resources to produce good & services
Public Good	Good / service with characteristic of non-excludability and non-rivalry
Positive Externalities	Benefits from production or consumption experienced by society but not by producers or consumers themselves
Negative Externalities	Costs from production or consumption experienced by society but not by producers or consumers themselves
Merit Goods	Goods or services deemed socially desirable by government and seen as underproduced and thus underconsumed
Demerit Goods	Goods or services deemed socially undesirable by government and seen as overproduced and overconsumed
Geographical Immobility	Where barriers to people moving from one region to another thus disallowing resources to respond to incentives to produce more goods & services demanded
Occupational Immobility	Mismatch of skills as labour is not transferable across industries as demanded, leading to waste of resources
Government Failure	Allocative efficiency is reduced following government intervention aimed to correct market failure

Macroeconomics

1. National Income Accounting

National income	Total value of an economy's final output of goods & services in a year (NNP at Factor cost)
Households	Basic consumers of finished products & owners of factors of production
Firms	Basic producers of finished products & buyers of factor services
Gross Domestic Product (GDP)	Total market value of all final goods & services newly produced within country
Gross National Product (GNP)	Total market value of all final goods & services newly produced by productive factors of country's citizens (GDP + NPIA)
GDP/GNP per capita	GDP / GNP divided by population
Net Property Income from Abroad (NPIA)	Difference between property income from abroad & factor income paid abroad
Market price	Value of output at shop level / price purchasers pay for goods & services sold
Factor cost	What factors of production received for goods & services produced
GDP at Factor cost	(GDP at market price – Indirect tax + Subsidies)
Capital depreciation	Loss in value of physical assets due to wear & tear
Net National Product (NNP)	(GNP – Depreciation)
Real GNP	Level of output in terms of physical quantities without price changes (Nominal GNP⁄GNP deflator)
Nominal GNP	Value of output measured at current prices
Purchasing Power Parity (PPP)	How much goods & services can be bought by a unit of currency at home compared with purchasing power of other countries' currency

2. National Income Determination

Keynesian Theory	Fundamental problem causing depression is insufficient demand for goods & services, so fiscal policy can revive the economy
Desired Aggregate Expenditure (AE)	Total planned expenditure on goods & services in an economy (C + I + G + X – M for 4-sector economy)
Equilibrium NI	Level of NI once reached will be maintained unless the economy is disturbed
Leakage / withdrawal	Siphoning off of expenditure from income flow between firms & households
Injection	Additional expenditure into domestic income flow
Autonomous consumption	Minimal consumption households will still spend when income is zero
Induced consumption	Amount of consumption changing when income changes
Average Propensity to Consume (APC)	Proportion of total income consumed (C⁄Y)
Average Propensity to Save (APS)	Proportion of total income saved (S⁄Y)
Marginal Propensity to Consume (MPC)	Change in consumption as income changes (ΔC⁄ΔY or 1 – MPS or 1 - MPW)
Marginal Propensity to Save (MPS)	Change in saving as income changes (ΔS⁄ΔY)
Marginal Propensity to Withdrawal (MPW)	Change in withdrawals as income changes (MPS + MPM + MPT)
Investment	Expenditure on production of capital goods and net additions to goods

	stocks
Marginal Efficiency of Investment (MEI)	Negative relationship between interest rates & level of investment
Government expenditure	Current spending & capital spending by the government on provision of goods & services
Full-employment level of NI	Level where there is no deficiency in demand / full employment of production factors / production on PPC
Deflationary gap	Shortfall of AE below NI at full-employment level, causing demand-deficient unemployment
Inflationary gap	Excess of AE above NI at full-employment level, causing demand-pull inflation
Multiplier (k)	Number of times income changes as injection changes (ΔY/ΔAE)
Aggregate Demand (AD)	Inverse relationship between price level & real equilibrium output where planned spending = actual output
Aggregate Supply (AS)	Amount of goods & services all firms in economy willing to supply at different price levels

3. Unemployment & Inflation

Unemployment	Number of people of working age without work, but willing & able to take up employment
Overheating	Economy growing too quickly that high inflation occurs
Labour force	All within working age (15<) who are able & willing to work and are either employed or seeking employment
Frictional unemployment	Unemployment occurring as workers change jobs / look for jobs after completing studies
Seasonal unemployment	Unemployment varying with season / weather
Structural unemployment	Unemployment resultant from geographical immobility of labour & occupational immobility of labour
Geographical immobility of labour	Labour unwilling to move to another region where prospects are better
Occupational immobility of labour	Labour that do not have the necessary skills required by the employer
Technological unemployment	Unemployment from labour made redundant as a result of increased automation
Cyclical / Demand-deficient / Keynesian unemployment	Unemployment as workers are retrenched in a recession / depression (as part of the business cycle)
Full employment	Occurs in economy when there is no cyclical unemployment
Inflation	Sustained increase in general price level of a country, as prices rise and value of money falls
Consumer Price Index (CPI)	Measures average price level of basket of goods & services consumed by typical household
Hyperinflation	Prices rise so fast that money ceases to be a medium of exchange & normal economic activity breaks down
Demand-pull inflation	Prices rise as supply cannot expand to meet demand
Cost-push inflation	Prices rise as production costs rise
Wage-push inflation	Inflation caused by wages rising faster than productivity gains
Import-price-push inflation	Inflation caused by inflation in other countries where goods are imported from or when local currency depreciates
Profit-push inflation	Inflation caused by firms use market power to raise prices above what is required to offset increases in cost of production to increase profits

Tax-push inflation	Inflation caused by increases in indirect taxes adding to cost of living
Wage-price spiral	Prices keep rising in vicious cycle as wages rise to offset higher costs of living & firms increase prices to cover appreciating costs of production
Anticipated inflation	Where rise in general price level is expected
Shoe leather costs	Costs incurred by people & firms trying to minimize holdings of cash

4. Public Finance

Current / Ordinary expenditure	Expenditure incurred in day-to-day routine work and recurrent year after year
Development / Capital expenditure	Spending on public investment
Progressive tax	As income increases, proportion of tax on one's income increases
Regressive tax	As income increases, proportion of tax on one's income decreases
Proportional tax	As income increases, proportion of tax on one's income remains the same
Income tax	Tax on 'earned' & 'unearned' income, taxed progressively
Corporation tax	Tax on firm's profits, usually taxed proportionally
Capital gains tax	Tax on capital gains and capital appreciation of assets (land, shares etc)
Property tax	Tax on annual rental value of land & buildings, usually proportional tax
Stamp duty	Tax on legal & commercial down payments
Ad valorem tax	Tax on fixed proportion of value of good or service (%)
Specific tax	Tax on fixed amount per unit of good or service ($)
Value-added tax (VAT)	Multi-stage tax levied on net value added at each stage of production
Excise duty	Tax on manufacturer of goods so as to curtail domestic consumption
Customs duties / Tariffs	Tax on goods imported from outside the country, to raise revenue or for protectionist reasons

5. Fiscal Policy

Government budget	Estimate of government revenue & expenditure for coming year
Balanced budget	Estimated revenue = Estimated expenditure
Deficit budget	Estimated revenue < Estimated expenditure
Surplus budget	Estimated revenue > Estimated expenditure
Deficit financing	Financing extra spending by government through other methods (e.g. borrowing)
Fiscal policy	Government policy where government expenditure is increased & taxes are reduced to stimulate economy
Automatic fiscal stabilizers	Built-in features of economy operating automatically to smooth out fluctuations in disposable income over business cycles, without government intervention
Disposable income	Income households have available to spend after paying income taxes & receiving transfer payments (e.g. unemployment benefits)
Crowding-out effect	Government cuts taxes or expands borrowing to finance increased expenditure, crowding out private investment due to higher interest rates

6. Interest Rate Determination & Monetary Policy

Money supply	Quantity / Stock of money held by households & firms in economy

Demand deposits	Money deposits in checking accounts (for checks)
Nominal money	Amount of money in dollars & cents
Real money	Amount of goods & services one can purchase with the money
Money substitutes	Items serving as temporary medium of exchange but not stores of value
Fiat money	Notes & coins determined as legal tender but not backed by gold, circulated by faith alone
Interest rates	(Rate charged) Cost of borrowing & reward for lending
Nominal interest rate	Interest rate charged by lender
Real interest rate	Nominal interest rate minus inflation rate
Demand for money	Desire to hold money rather than spend it or for financial investment
Liquidity preference	Desire to hold non-interest bearing cash balances as part of wealth portfolio instead of interest-bearing bonds
Transactions motive	Cash balances to meet planned expenses
Precautionary motive	Cash balances to meet unforeseen expenses
Speculative motive / Idle balances	Cash balances to purchase assets & bonds to make capital gains
Total demand for money	Active balances (Transactions motive & precautionary motive) + Idle balances
Loanable funds	Funds available for lending
Central bank	Institution supervising monetary system, implementing monetary policy & ensuring banks & financial institutions operate efficiently
Monetary policy	Deliberate attempt by Central Bank to regulate money supply or manipulate interest rates
Irrational exuberance	Consumers continue to spend regardless of high interest rates because of high consumer confidence
Velocity of money	Rate at which money supply turns over each year

7. Economic Growth

Economic growth	Annual percentage increase in real value of goods and services produced by economy
Actual economic growth	Annual percentage increase in national output
Potential economic growth	Speed at which economy could grow / Percentage annual increase in economy's capacity to produce
Human capital	Accumulated skill & knowledge of workers

8. Supply-side Policy

Supply-side policy	Focusing on adjusting AS such that the AS curve expands outwards
Prices & income policy	Direct or indirect intervention by government on wage-price setting to influence inflation rate
Earnings	Wages + Overtime payments + Bonuses

9. International Trade

Trade	Exchange of goods & services between two parties
International trade	Exchange of goods & services across national borders
Factor price equalization	Prices of factor inputs brought closer to each other
Absolute advantage	Where a country can produce more of a good using the same amount of resources

Comparative advantage	Where a country can produce a good at a lower opportunity cost than another country
Law of comparative advantage	Trade can benefit all countries if they specialize in goods in which they have a comparative advantage
Terms of trade (TOT)	Rate at which one good can be exchanged for another
Terms of trade index	Comparison of export price index with import price index (Export Price Index/Import Price Index X 100%)
Balance of trade (BOT)	Difference between value of commodity exports & imports (Export revenue-Import spending)
Free trade	Exchange of goods & services between countries without any artificial restrictions
Protectionism	Policy of sheltering domestic industries from foreign competition through tariff & non-tariff barriers
Infant industry	Industry with potential comparative advantage but too young / undeveloped to realize potential
Dumping	Selling of goods in foreign market below cost price / price sold in home market
Import quota	Legal limit on quantity of imports over given time period
Subsidy	Indirect protection of domestic producers so they become more competitive against more efficient foreign producers
Voluntary restraint agreement (VRA)	Agreement to reduce trade volume in specific good
Exchange control	Government's buying & selling of foreign exchange to regulate imports & exports to ensure healthy BOP and prevent undue fluctuations in country's foreign exchange value
Embargo	Total ban on certain imports
Economic integration	Neighboring countries integrate as an economic unit to take advantage of extended market & allow better allocation of resources
Free trade area (FTA)	Agreement where member countries agree to remove tariff & non-tariff barriers among themselves but retain restrictions against non-member countries
Trade deflection	Imports enter FTA via country with lowest external tariff
Customs union (CU)	Agreement where member countries remove all trade barriers among themselves & adopt common external tariff for non-member countries
Common market	Member countries operate as a single market, lifting all restrictions on trade in services, capital & labour movements and adopting laws & regulations on trade, production & employment
Trade diversion	Trade diverted from more efficient non-member producer to less-efficient but tariff-free member nation
Balance of payments (BOP)	Summary statement of money value of economic transactions between country residents & rest of world
Credit item (+)	International transaction earning foreign currency, providing demand of domestic currency
Debit item (-)	International transaction requiring foreign currency to make payments, providing supply of domestic currency
Current account	Flow of goods & services + incomes & net transfer of money flowing into & out of country
Trade in goods account	Import & export of tangible goods
Trade in services account	Import & export of services (invisibles)
Income flows	Investment income in forms of rent, interest, profits & dividends (net property income from abroad)

Current transfers	Unilateral flows such as government contributions & receipts from international organizations & remittances
Capital account	Records debt forgiveness, migrant transfers & acquisition & disposal of non-financial assets such as patents & copyrights
Financial account	Records purchase & sales of assets in terms of direct investment, portfolio investment & monetary flows
Direct investment	Purchase & sale of real assets (capital goods)
Portfolio investment	Purchase & sale of shares & bonds (long-term investment)
Monetary flows	Bank deposits, loans & debts (short-term investment)
Balancing item	Statistical adjustment to record errors & omissions in calculations
Official Reserves Account (ORA)	Accommodates surpluses or deficits in overall balance
BOP equilibrium	Trade & capital flows into & out of country equal over number of years
BOP disequilibrium	Persistent tendency for outflows to be greater or less than corresponding inflows
Expenditure-reducing policies	Contractionary demand-side policies to reduce imports and hence AD & NI of country
Expenditure-switching policies	Policy that raises import prices relative to domestic-produced goods
Marshall-Lerner (ML) condition	Sum of PED_X & PED_M > 1 for devaluation of currency to be successful in correcting adverse BOP
J-curve effect	Where current account worsens in short-run after currency devaluation before improving
Foreign exchange (Forex)	Trading of one country's currency for another foreign currency
Exchange rate	Rate at which one currency is exchanged for another
Nominal exchange rate	Exchange rate based on nominal value of currency before adjustment to price changes
Bilateral exchange rate	Exchange rate between two currencies
Trade-weighted / Effective exchange rate	Value of currency against basket of other currencies of major trading partners
Derived demand for currency	Currency demand stems from foreigners' demand for our goods, services & financial assets
Depreciation	One currency weakens relative to another, when demand for it falls or supply for it rises
Appreciation	One currency strengthens relative to another, when demand for it rises or supply for it falls
Purchasing power parity (PPP) theory	Equilibrium rate of exchange between two currencies determined by relative domestic purchasing power; exchange rates between two currencies in equilibrium when equivalent domestic purchasing power
Fixed exchange rate	Government of country fixes & guarantees official price of currency in terms of other foreign currencies
Devaluation	Government declares lowering of fixed exchange rate
Revaluation	Government declares raising of fixed exchange rate
Freely-floating / Flexible exchange rate	Exchange rate determined freely by market forces of demand & supply in forex market
Managed float exchange rate	Government lets market forces determine exchange rate but will interfere to change it if beyond certain band