Glossary

Absolute advantage is a concept developed by Adam Smith that refers to a country or other economic entity being the more efficient producer of a good or service.

Absolute Income Hypothesis *see* **Keynesian Consumption Function**.

Accelerator model of investment states that inventory investment will respond positively to output.

AD-CCE-BT Model *see* **Salter-Swan Model**.

Aggregate Demand (AD) Schedule represents the total expenditure of the real macroeconomy, e.g. consumption, investment, government spending and net exports.

Aggregate Demand and **Aggregate Supply (AD-AS) Model** is a general equilibrium model that simultaneously determines output and prices.

Aggregate Supply (AS) Schedule plots the relationship between the output of an economy and the price level.

AK Model is a strand of endogenous growth theory that explains economic growth rates in the long run as determined within the model.

Autarky is a closed economy which does not engage in trade with other nations.

Autonomous consumption, *a*, is consumption which is undertaken independently of income.

Balance of payments is one nation's accounts with the rest of the world.

Balance of trade (BT) *see* **Trade Balance**

Balanced budget multiplier states that national income will change proportionately with the change in government spending or $\Delta Y = \Delta \overline{G}$.

Balanced growth path of an economy is when it is in steady state and grows at the rate of technological progress. This also implies that capital, output, consumption and population are growing at constant rates.

'Big bang' or **'shock therapy'** is a rapid transition to marketization.

BP curve represents the combination of income and interest rates where the balance of payments (or the external part of the economy) is in equilibrium.

Broad capital includes both physical and human capital.

Business cycle refers to short-run, temporary fluctuations in output.

Capital Asset Pricing Model (CAPM) is a model in which assets that offer high returns in the states of the world where income is low are relatively highly priced, and vice versa.

Capital deepening is when the economy is not in equilibrium and capital per worker is increasing.

Capital stock is the amount of capital accumulated as a result of investment.

Capital widening is when the economy is not in equilibrium and capital per worker is declining as the amount of investment per worker is not enough to keep the capital–labour ratio constant.

Circular flow of income captures the interactions among the firms, households, government, financial institutions and foreign sector in the economy.

Comparative advantage of a nation lies in it producing goods in which it is relatively more efficient.

Competing claims equilibrium (CCE) is the long-run aggregate supply curve in an open economy, which captures the relationship between the real exchange rate and the equilibrium level of output.

Competitiveness is determined by the real exchange rate, which is the ratio of foreign to domestic prices in terms of the domestic currency.

Conditional convergence is the hypothesis that predicts that countries will converge in growth rates conditioned on differences in steady states.

Consumption is the act of deriving a flow of benefits from the usage of goods or services.

Convergence hypothesis predicts that developing countries will grow faster than developed countries, if they have the same steady state.

Crowding out occurs when fiscal policy reduces investment by increasing the interest rate.

Currency crises are sharp depreciations in a nation's currency brought about by large movements on international foreign exchange markets.

'Dual track' approach is the type of gradualist transition undertaken by China where a market sector exists alongside an administered one.

Economic growth is the change in GDP on an annual basis. *See also* **Long-run growth.**

Efficient markets hypothesis (EMH) states that prices in financial markets fully reflect the available information.

Endogenous growth theories explain long-run economic growth by focusing on and incorporating the factors that determine technological progress.

Expected Dividend Model relates the price of an asset to its stream of expected future dividends.

Export-led growth is a growth strategy that focuses on gaining global market share to lead economic growth.

Exchange rates are the rate at which one currency can be converted into another.

Expectations augmented Phillips curve relates the actual rate of inflation to the difference between the rate of unemployment and the equilibrium rate, and the expected level of inflation.

Extensive growth is economic growth through an expansion of inputs.

Fiscal policy is government spending and taxation.

Foreign direct investment or FDI typically refers to long-term investment by foreigners in another country.

Full employment level of output is where prices will rise if output exceeds this level in the neoclassical IS-LM Model.

Gains from trade refers to the welfare-enhancing effects of when countries specialize and exchange with other nations.

Gini coefficient is twice the distance between the 45-degree line and the Lorenz curve. It is a measure of absolute inequality obtained by examining the difference in incomes among households, for instance. A measure of 1.00 refers to a completely unequal society and zero would indicate a completely equal one.

Globalization has many definitions, but we use it to refer to the interconnectedness among nations.

Gordon Model is a commonly used variant of the Expected Dividend Model, which assumes that the stream of future dividends are described by a constant growth rule.

Government spending is a component of the circular flow of income.

Gradualist transition path depicts transition to a market-oriented economy through incremental changes.

Gross Domestic Product (GDP) is a measure of the total output produced by an economy. There are three different ways of calculating the level of national output; these are the expenditure method, income method and output method.

GDP per capita is the level of GDP divided by the country's population.

Growth accounting is a framework that accounts for the contribution to output from inputs of factors (capital and labour) and from total factor productivity.

Human capital refers to the skills and educational level of workers.

Hysteresis describes a situation where nominal factors may leave permanent effects on output.

Import-substitution industrialization is a protectionist growth strategy where domestic markets are served by domestic firms, which are shielded from foreign competition.

Injections are items which add to the circular flow of income, that is, investment (I), government spending (G) and exports (X).

Intensive growth is economic growth through technological advancement.

Interest rate is the price of money.

International trade is trade of goods and services among nations.

Intertemporal budget constraint defines all the feasible consumption patterns that a household can choose across time periods.

Investment demand schedule shows that investment is downward sloping with respect to the interest rate.

IS-LM Model is a general equilibrium model which determines the combinations of income (Y) and interest rates (r), where both the goods (real side of the economy) and money markets (nominal side of the economy) are in equilibrium.

ISXM Schedule represents equilibrium in the good market, including net exports.

J-curve effect following a depreciation predicts that the terms of trade will first deteriorate, followed by an improvement in the balance of payments.

Keynesian Consumption Function states that households base consumption decisions on current income.

Leakages from the circular flow are those items which lead to lower income flows, that is saving (S), taxes (T) and imports (M).

Life Cycle Hypothesis states that individuals save during their working life, and dissave before working and after retirement.

Lifetime utility function gives the amount of utility or satisfaction a household will achieve from its lifetime pattern of consumption.

Liquidity trap is where the demand for money demand is perfectly interest elastic.

Long-run aggregate supply corresponds to the level of output consistent with equilibrium in the labour market.

Long-run growth is the rate of growth that is consistent with an economy's natural rate of output and the position of the long-run aggregate supply curve.

Long-run Phillips curve is vertical at the NAIRU, but is consistent with many different rates of inflation, depending on inflation expectations.

Marginal product of capital (MPK) states the change in total output when the capital stock changes by one unit.

Marginal propensity to consume (mpc) is the change in consumption that would result from a change in income.

Marginal propensity to save (mps) is the change in saving that would result from a change in income.

Marshall-Lerner condition states that following an exchange rate depreciation, the balance of payments will improve if the sum of the price elasticity of demand for exports and imports exceeds 1.

Monetary policy is the act of the government in controlling the supply or price of money.

Money is anything which performs the following functions: acts as a medium of exchange, a unit of account, a store of value, and serves as a standard for deferred payments.

Money multiplier is the ratio of money supply to the monetary base.

Mundell-Fleming Model is a version of the IS-LM-BP Model with perfect capital mobility.

National debt (or surplus) is the accumulated total of all a government's deficits and surpluses.

National income accounting has a direct relationship to the circular flow of income, as there are three methods of calculating GDP which should produce the same measure of national income.

Natural rate of unemployment is the level of unemployment when a perfectly competitive labour market is in equilibrium.

Net barter terms of trade is the ratio of an index of export prices to an index of import prices.

Neutrality of money states that money is incapable of altering the real parts of the economy; its only impact will be on the nominal factors, such as prices.

New Keynesian theories of fluctuations state that cycles are the result of price and wage rigidities, which prevent markets from clearing.

Non-accelerating inflation rate of unemployment (NAIRU) is the rate of unemployment consistent with equilibrium in the labour market where no wage or price pressures exist.

Optimal capital stock model (or neoclassical model of investment) argues that firms have a desired level of capital stock, and investment simply acts to move the current capital stock in that direction.

Optimal currency areas (OCA) an economic region is an optimal currency area if the advantages of adopting a single currency outweigh the disadvantages.

Permanent Income Hypothesis states that individuals base consumption decisions on permanent and not transitory income.

Phillips curve shows an inverse relationship between unemployment and inflation.

Poverty is typically measured as the number of people living below a minimum standard of living.

Precautionary saving is saving in order to take precautions against uncertain future events.

Present discounted value is the current value of a future sum.

Production possibility frontier (PPF) gives the maximum of what can be produced by an economy with its factors of production.

Purchasing power parity (PPP) is a theory of exchange rate determination, which argues that the exchange rate will change so that the price of a particular good or service will be the same regardless of where you buy it. It is often known as the law of one price.

q theory of investment (Tobin's q) links stock markets to investment by setting a value of q as equal to the ratio of the market value of the firm over the replacement cost of capital. If q is greater than 1, then the firm should invest.

Real business cycle (RBC) theory argues that output fluctuations are the result of productivity shocks.

Ricardian equivalence states that fiscal policy will not affect national income because consumers are rational and forward-looking.

Salter-Swan (AD-CCE-BT) Model consists of three equilibrium relationships examining the links between competitiveness and, in turn, the trade balance, aggregate demand and aggregate supply.

Saving is the amount of income that is not consumed by households.

Social capital refers to the norms, trust and relationships within a community.

Solow Model is the neoclassical model of long-run economic growth. Variants of the Solow Model include with technology and human capital.

Solow residual is the unexplained portion of output that is not attributable to the measured inputs and is known as total factor productivity (TFP) in growth accounting exercises.

Stabilization policy refers to the government's use of monetary and fiscal policies to offset the economic cycle.

Steady state of an economy is when the economy is in equilibrium.

Sustainable level of output in the AD-AS-CCE Model is where the CCE and BT curves intersect.

Technological progress is advances in technology that increase the productivity of factors of production.

Technology transfers are transfers of know-how from developed to developing countries.

Tobin Model of Portfolio Selection describes how investors choose the composition of their portfolios, by assuming that each has preferences over risk and return which can be represented in a utility function.

Tobin's q *see* q theory of investment.

Tobin tax is a tax on any short-term international transaction.

Total factor productivity refers to productivity advances or technological progress.

Trade balance (BT) is the value of exports minus the value of imports.

Uncovered interest parity (UIP) is a theory of exchange rate determination, which argues that the exchange rate will be determined in the market for internationally traded financial assets.