

Economic Definitions

Utility: satisfaction derived from consuming a good. Profit: Profit = TR - TC = Q(AR-AC). Normal Profit: profit that the firm could make by using its resources in their next best use (opportunity cost) Supernormal profit: profit above normal profit. Welfare maximization: Adaptive Expectations: where decisions are based upon past information. Rational Expectations: where decisions are based on current information and anticipated future events. Rational economic behavior: Positive: scientific or objective study of the allocation of resources Normative: study and presentation of policy prescriptions involving value judgements about the way in which scarce resources are allocated. (subjective approach to economics) Free Good: goods which are unlimited in supply and which therefore have no opportunity cost. Economic Good: goods which are scarce because their use has an opportunity cost. Scarcity: economic agents (firms, governments,?) can only obtain a limited amount of resources at any moment in time. Choice: economic choices involve the alternative uses of scarce resources Opportunity cost: economic cost of production, benefit lost from the next best alternative. Production possibility frontier: curve which shows the maximum potential level of output of one good given a level of output for all other goods in the economy. Short Run: period of time when at least one factor input cannot be varied. Long Run: period of time when all factor inputs can be varied, but the state of tech. remains constant. Very Long Run: the period of time when the state of technology may change. Factors of Production: Land: all natural resources Labor: workforce Capital: manufactured stock of tools, machines, factories, offices, roads and other resources used in the production of goods and services. Entrepreneurship: those who organize production, and take risks. Market: occurs whenever buyers and sellers are in contact with each other. Ceteris Paribus: 'all other things remaining the same?', the assumption that all other variables within an economic model remain constant whilst one change is being considered. Externalities: Merit Good: good which is under-provided by the market mechanism. // has positive externalities. Public Good: good where consumption by one person does not reduce the amount available for consumption by another person, (non-excluding / non-rivalrous) leads to the concept of the free rider. i.e.: defense, streetlights. Private Good: Goods which are excludable, rivalrous. Centrally Planned Economy: economic system where the government, through a planning process, allocates resources in society. Free Market Economy: economic system which resolves the basic economic problem through the market mechanism. Normal Good: good where demand increases when income increases (YED > 0) Inferior Good: good where demand falls when income increases (YED < 0) Giffen Good: special type of inferior good where demand increases when price increases Veblen Good: (snob goods) goods bought in order to gain status, often sell better at high prices. Speculative goods: a fall in price will discourage people from buying (sometimes) b/c they are afraid of further falls in price. Substitution Effect: if price rises, demand will switch to substitute products. Income Effect: if prices rises, real income will diminish, and demand will change according to whether the good is normal or inferior. Law of Diminishing Returns: if increasing quantities of a variable input are combined with a fixed input, eventually the marginal product and the average product of that variable input will decline. Returns to scale: when the change of percentage output is the same as the percentage change in input. Economies of Scale: a fall in the long run average costs of production as output rises. Internal: resulting b/c of growth in the scale of production within a firm. External: resulting from a growth in the size of the industry in which a firm operates. Types: Technical: automation, specialized equipment, increased dimensions. Financial: easier credit, lower rate of interest. Managerial: specialized departments. Marketing: advertising (brand name, sponsorship, ?), packaging. Risk-bearing: diversify. Monopolistic Competition: market structure where a large number of small firms produces non-homogeneous products and where there are no barriers to entry or exit. Oligopoly: market structure where there is a small number of firms in the industry and where each firm is interdependent with other firms. Monopoly: market structure where one firm supplies all output in the industry without facing competition because of high barriers to entry to the industry. Natural Monopoly: where economies of scale are so large relative to demand that the dominant producer in the industry will always enjoy lower costs of production than any other potential competitor. Perfect Competition: market structure where there are many buyers and sellers, where there is freedom of entry and exit to the market, perfect knowledge, and where all firms produce a homogeneous product. Imperfect Competition: market structure where there are several firms in industry, each of which has some ability to control the price they set for their product. Horizontal Merger: merger between two firms in the same industry at the same stage of production. Vertical Merger: merger between two firms at different production stages in the same industry. Consumer Sovereignty: when resources are allocated according to the wishes of consumers (i.e.: in a perfectly free market) Profit Maximization: MC = MR Maximum Revenue: MR = 0 Optimal Allocation: Productive Efficiency: production is at lowest cost (MC = AC) Allocative Efficiency: occurs when no one can be made better off by transferring resources from one industry to another without making someone else worse off. (Price = MC) // this is the social optimum Market failure: where resources are inefficiently allocated due to imperfections in the working of the market mechanism. Externality: Negative: if net social cost is greater than net private cost. Positive: if net social benefit is greater than net private benefit. Internalizing: eliminating the externality by bringing it back into the framework of the market mechanism. (i.e.: extending property rights) Private cost and benefit: cost or benefit to an individual economic unit such as a consumer or a firm. Social cost and benefit: cost or benefit to society as a whole. Gross: Net: Domestic Income: excludes the values of incomes generated by assets owned overseas and domestic assets owned by foreigners. National Income: includes the above. Factor Cost: Market prices: Nominal: values unadjusted for the effects of inflation / values at current prices Real: values adjusted for inflation Macroeconomic Policy Objectives: Economic growth and development Full employment Price stability External equilibrium GDP: measure of national income before property income from abroad and depreciation have been accounted for. GDP (factor cost): GDP (market prices) - Taxes (indirect) + Subsidies GNP: a measure of national income including net property income from abroad but before depreciation. Multiplier: figure used to multiply a change in autonomous expenditure, such as investment, to find the final change in income / ratio of the final change in income to the initial change in autonomous expenditure. Accelerator Theory; theory that the level of planned investment is related to past D Y. (I=f(D Y)) Absolute advantage: when a country is able to produce a good more cheaply in absolute terms than another country. Comparative advantage: when a country

is able to produce a good more cheaply relative to other goods produced domestically than another country. Free Trade Areas: group of countries between which there is free trade in goods and services but which allows member countries to set their own level of tariffs against non-member countries. Customs unions: Common markets: group of countries between which there is free trade in products and factors of production, and which imposes a common external tariff on imported goods from outside the market. Current Account: part of Balance of payments where payments for the purchase and sale of goods and services are recorded. Capital Account: part of the B.o.P. where flows of savings, investment and currency are recorded. Long run: Short run: Current Balance: difference between total exports and total imports. Marshall-Lerner Condition: devaluation will result in an improvement on current account if the combined elasticities of demand for exports and imports are greater than 1 (more elastic ? better to devalue) Terms of Trade: Economic Growth: Economic Development: Human Development Index (HDI): compares countries on the basis of real GDP per capita at PPP, life expectancy, education (literacy and school enrolment) Human Suffering Index (HSI): takes into account factors such as access to clean water, adequate food, and education. Valuing Natural Resources: takes into account growth without the destruction of natural capital. Measure of Economic Welfare (MEW): allows for leisure, non-marketed goods, public amenities, as well as economic ?bads? like pollution or ?regrettables? like defense spending. Net Social Product (NSP): adjusts for positive and negative externalities to calculate social benefits and social costs, including pollution, divorce, crime and suicide rates. Formulae PED: $\frac{\% \Delta Q_D}{\% \Delta P} = \frac{P}{Q} \frac{dQ}{dP}$ // $\frac{P}{Q} \frac{dQ}{dP} > 1$ elastic // $\frac{P}{Q} \frac{dQ}{dP} < 1$ inelastic // $\frac{P}{Q} \frac{dQ}{dP} = 1$ unitary PES: $\frac{\% \Delta Q_S}{\% \Delta P}$ YED: $\frac{\% \Delta Q_D}{\% \Delta Y} = \frac{Q_D}{Y} \frac{dQ_D}{dY}$ // $\frac{Q_D}{Y} \frac{dQ_D}{dY} > 1$ = normal good // $\frac{Q_D}{Y} \frac{dQ_D}{dY} < 1$ = inferior good // $\frac{Q_D}{Y} \frac{dQ_D}{dY} = 1$ = luxury good XED: $\frac{dQ_x}{dP_x}$ // Substitutes: XED > 0 // Complements: XED < 0 // APC: the proportion of income consumed, $APC = C/Y$ APS: $APS = S/Y$ $APC + APS = 1$ MPC: $MPC = dC/dY$ MPS: $MPS = dS/dY$ $MPC + MPS = 1$ $C = a + b(Y)$ // Consumption = autonomous $C + MPC * \text{Income}$ $AD = C + I + G + (X-M)$ $m = D Y/D I$ // also $m = 1 / MPS$ in a simple closed economy. Gov. Spending $m = D Y/D G$ Bank/credit $m = 1 / \text{Reserve Ratio}$ $MV = PQ$ // $M = \text{Money Supply}$ // $V = \text{income velocity of circulation}$ // $P = \text{price level}$ // $Q = \text{real GDP}$ Monetarists believe: $D M ? D P$ Standard of Living = Real GDP / Population

About the Author

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