Glossary of Economics Terms

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Introduction

In this publication, we provide an explanation of terms used in the world of Economics.

This glossary is limited to economics terms but we publish several other glossaries as well – check our website or call us for details.

Economics Terms Glossary

- **AAA-rating -** The best credit rating that can be given to a corporation's bonds, effectively indicating that the risk of default is negligible.
- **Abnormal Loss -** An abnormal loss is where total revenue does not cover total cost. It is a situation where a firm is making below normal profits. If abnormal losses persist in an industry firms will tend to leave, prices will rise and normal profits will be restored.
- **Abnormal Profits -** Profits exceed the amount a firm must receive to carry on production. Also known as supernormal profit. If abnormal profits persist in an industry this will tend to attract new firms in, supply will increase, prices will fall and normal profits will be restored. If there are barriers to entry then abnormal profits may persist in the long-run.
- **Absolute Advantage -** Exists when a country can produce more of a product per resource unit than another country. It is a basis for trade. A country with an absolute advantage is producing more efficiently than another.
- **Absolute Income Hypotheses -** The Keynesian view that consumption depends on current disposable income.
- **Absolute Poverty -** Experienced when income levels are inadequate to enjoy a minimum standard of living. This is contrasted with relative poverty which is where income levels are relatively too low to enjoy a reasonable standard of living in that society.
- **Absolute price -** The price of a good or service, expressed in units of money.
- **Absorption Pricing -** A means by which the fixed costs are shared between all the products that are sold. The fixed costs are said to be absorbed into the price of the goods, as the price charged reflects the variable costs of each item plus a share of the fixed costs.
- **Accelerator -** The principle states that a given change in demand for consumer goods will cause a greater percentage change in demand for capital goods. The principle is used to help explain business cycles. The accelerator theory suggests that the level of net investment will be determined by the rate of change of national income. If national income is growing at an increasing rate then net investment will also grow, but when the rate of growth slows net investment will fall. There will then be an interaction between the multiplier and the accelerator that may cause larger fluctuations in the trade cycle.
- **Accumulation -** Gross accumulation is the acquisition of fixed assets, stocks of non-durable goods, land, mineral deposits and other non-reproducible tangible assets, financial assets, patents, copyrights and other tangible assets during a period of account less the incurrence of liabilities. Net accumulation is gross accumulation during a period reduced by the consumption of fixed capital.
- **Acquired Advantages -** Location benefits which develop over time.
- **Active Labour Market Policy (ALMP) -** A set of policies aimed at improving the functioning of the labour market by enhancing labour market mobility and adjustment, facilitating the redeployment of workers to productive activities and, generally, enabling people to seize new job opportunities as they arise.
- **Activity Rate -** The percentage of the population of working age in the labour force.
- **Actual Output -** What we are producing at any given time. If our actual output is less than our potential, we call this an output gap.
- **Ad Valorem Tax** - A tax that is a percentage of the selling price. In the UK, an example of an ad valorem tax would be VAT.
- **Adam Smith -** Adam Smith, the "father" of economics, developed much of the theory about markets that we regard as standard theory now. In his main work, 'The Wealth of Nations' he stressed the benefits of division of labour (specialisation) and its need, and outlined the workings of the market mechanism (price system). Perhaps the concept most associated with him is the 'invisible hand'. He argued that markets would guide economic activity and act like an invisible hand allocating resources. Prices would be the main means to do this: they would rise when there was a shortage of something and fall when it was plentiful.

- **ADB -** Analytical Data Base maintained by the OECD Secretariat and underlying the projections presented in the Economic Outlook.
- **Adjustable Peg -** When the exchange rate is maintained within agreed margins around a central parity but with the possibility that the central parity may be changed.
- **Administration -** A rescue mechanism for UK companies in severe trouble. It allows them to continue as a going concern, under supervision, effectively to try to trade out of difficulty. A firm in administration cannot be wound up without permission from a court.
- **Advances -** An advance is a loan given by a financial institution. These loans can take various forms and need to be repaid with interest.
- **Ageing Population -** When the average age per person is rising. This is currently true of the UK.
- **Aggregate Demand Curve -** The aggregate demand curve shows the level of aggregate demand at every price level. It will always be downward sloping as there will always be less demand at higher price levels.
- **Aggregate Demand -** The total of demand (all planned expenditure) in an economy at each level of prices. Total aggregate demand is the sum of consumer, firm and government expenditure plus net exports (exports - imports). Also known as Aggregate monetary demand.
- **Aggregate Supply Curve -** The aggregate supply curve shows the amount that will be supplied by the firms in the economy at each price level. Many classical economists and monetarists argue that the shape differs between the short-run and long-run. In the short-run there may be some increase in output if demand increases, but in the long-run any increases in demand will be inflationary. However, Keynesians do not distinguish between the short-run and long-run. They believe in a curve that shows a gradual bottleneck in production pushing up prices as the level of full-employment is reached.
- **Aggregate Supply -** The total of supply (all planned production) in an economy at every price level. It is the total of all goods and services produced in an economy in a given time period.
- **Aid -** Assistance given to an individual, firm, region or government. Usually used in the context of overseas aid where governments assist other countries.
- **Alienation –** The dissatisfaction workers feel with the tasks they are required to perform.
- **Allocative Efficiency -** A market will be allocatively efficient if it is producing the right goods for the right people at the right price. An allocatively efficient market is therefore one which has no imperfections. This will be true when marginal cost is equal to average revenue in the market.
- **Allocative Inefficiency -** Occurs when it is possible to redistribute goods to increase the welfare of any one consumer without reducing the welfare of some other consumer.
- **Alpha (and Alpha Coefficient) -** a mathematical estimate of the amount of return expected from the inherent values of an investment. It measures the portion of an investment's return from specific (non-market) risk. It is the difference between an asset's actual performance over a specified period of time and the performance that might have been expected using its volatility relative to "the market" (the beta coefficient). It measures risk-adjusted performance, factoring in the risk due to the specific security, rather than the overall market. A high value for alpha implies that the asset has performed better than would have been expected given its beta (volatility).
- **Amortisation -** The paying off or discharge off of a loan principal over time.
- **Amplitude -** The distance from peak-to-trough in the business cycle. In general, the larger the amplitude is the more volatile the business cycle will be.
- **Ancillary Firms -** Firms which provide goods and services for other firms.
- **Annual Equivalent Rate (AER) -** This is a notional rate that is generally quoted on interest paid on savings and investments. It is intended to demonstrate what your interest return would be if the interest was compounded and paid annually instead of monthly (or any other period). The gross AER is the contractual rate of interest payable before the deduction of income tax. Net AER is the amount of interest payable after allowing for the deduction of basic rate tax.
- **Annualised Rate of Growth (AR) -** The rate of growth over a specified period (e.g. a quarter or a half-year) expressed at an annual rate. In the OECD Economic Outlook, growth rate numbers in texts and tables are given at annual rates, unless otherwise mentioned.
- **Annuity -** This usually refers to an insurance related investment product that guarantees or aims to pay a stated amount to the holder every year. The payments may be at a fixed interest rate (Fixed Annuity) or a variable rate (Variable Annuity). The insurance

annuity usually offers tax deferral benefits as well.

- **Anti-Dumping Measures -** Dumping takes place when a product is exported at less than its normal value. Anti-dumping measures may take the form of duties or of price undertakings. Anti-dumping duties are generally enterprise-specific duties levied on certain goods to offset the dumping margin. Anti-dumping price undertakings may be offered to exporters to avoid the imposition of anti-dumping duties.
- **Appreciation of Sterling -** When market forces raise the value of sterling from one rate to another. This may be caused either by an increase in demand and/or perhaps a decrease in supply of the currency.
- **Appreciation -** An increase in the value of an asset or currency.
- **Appropriate Technology -** A technology that complements the factor endowments of the country.
- **Appropriation Accounts -** Detailed sources of income and expenditures, saving and net lending for key economic sectors such as general government, businesses and households.
- **Arbitrage -** Buying securities in one country, currency or market, and selling in another simultaneously to take advantage of price differences
- **Arch/Stochastic Volatility Models -** Time series models that allow for time-varying variances.
- **ASEAN -** Association of Southeast Asian Nations.
- **Asia-5 Countries -** The principal Asian economies affected by financial market turmoil since 1997. These include Indonesia, Korea, Malaysia, the Philippines and Thailand.
- **Asset** - Something that has earning power or some other value to its owner. For banks, their main assets will be cash and any investments they have (including their holdings of government securities). For individuals, their assets may be either cash in the bank, properties or perhaps other financial assets like gilt-edged securities.
- **Automatic Stabilisers -** Changes in government expenditure and tax revenue which occur without any change in government policy as GDP increases or falls. Automatic stabilisers will help to dampen fluctuations in the trade cycle.
- **Autonomous Consumption -** The level of consumption when income is zero. It is consumption that does not vary with income.
- **Autonomous Expenditure -** The amount spent in an economy even when income is zero. It does not vary with income.
- **Average Cost Pricing -** Setting price equal to average cost.
- **Average Cost -** The amount spent on producing each unit of output. The average cost is calculated by dividing the total level of cost by the level of output. The average cost curve will tend to be u-shaped due to the presence of increasing and then diminishing returns.
- **Average Earnings -** Total earnings divided by those in employment. Average earnings are often expressed as an index; the average earnings index.
- **Average Fixed Cost -** Total fixed cost divided by output. It declines as output increases.
- **Average Product of Labour -** The average product is the output per worker. It will tend to rise initially in the short run with increasing returns to the variable factor, but will eventually begin to fall when diminishing returns set in. The marginal product curve will intersect the average product curve at its peak.
- **Average Propensity to Consume -** The proportion of disposable income spent: APC = expenditure/income. For example, if a person spends 4,000 of a 10,000 income, the APC is 0.4.
- **Average Propensity to Save -** The proportion of disposable income saved: APS = savings/income. For example, if a person spends 4,000 of a 10,000 income, then they have saved 6,000. The APS is therefore 0.6.
- **Average Rate of Tax -** The average rate of tax is the total amount of income tax paid as a percentage of a person's income.
- **Average Revenue Curve -** A curve which plots average revenue. It is equivalent to the demand curve.
- **Average Revenue -** The total revenue divided by the level of output. It is therefore the price.
- **Average Variable Cost -** The total variable cost divided by output. The average variable cost curve will generally be u-shaped because of the presence of increasing returns in the short run, initially reducing average variable costs. Eventually, however, diminishing returns will set in and the average variable cost will start to rise.
- **Backwardation -** a futures market term: the situation in which, and the amount by which, the price of a commodity for future delivery is lower than the spot price or a far future delivery price lower than a nearer

future delivery. One says that the forward curve is "in backwardation" (or sometimes: "backwardated"). Backwardation is a situation where the cash price of a commodity is pregnant with a premium a buyer is willing to pay for the immediate delivery of the commodity. Formally, backwardation means a downward sloping forward curve (as in an inverted yield curve). A backwardation starts when the difference between the future price and the cash price is less than the cost of carry. The opposite market condition to backwardation is known as *contango*.

- **Backward Integration -** Occurs when a company joins with a firm that is involved at an earlier stage of the production chain.
- **Backward Sloping Supply Curve -** A curve showing that as the price of a good or service rises, so the quantity offered for sale falls.
- **Bad Loans -** Defined as loans which are in arrears exceeding a certain time limit and/or for which the value of collateral has been eroded or disappeared for economic reasons.
- **Balance of Payments -** The balance of payments account records all flows of money in and out of the UK. These flows might result from the sale of exports (an inflow or credit) or from the UK purchasing imports from overseas (an outflow or debit). They might also arise from other countries investing in the UK (inward investment - a credit), or from UK companies investing abroad (a debit).
- **Balance of Trade -** The value of visible exports minus the value of visible imports.
- **Balance Sheet Account -** Account showing the assets, liabilities and net worth of an institutional unit, or class of such units, as of a given date.
- **Balanced Budget -** When government income matches government expenditure. Classical economists argued that this should always be the aim of government policy. Keynesians on the other hand said that in times of low economic activity the government should run a deficit (spending more than its revenue) to boost the economy and when the economy was booming they could run a surplus (spending less than revenue). In this way they could balance the budget in the long-run.
- **Balancing Items -** Represents the net total of errors and omissions in the other items in the balance of payments. Adding this to the current account balance and the capital account balance should give a result of zero, indicating that the balance of payments balances.
- **Balanced Job Complex –** This a balanced job complex is a collection of tasks within a given workplace that is balanced for its equity and empowerment implications against all other job complexes in that workplace. It was developed as an alternative to the corporate division of labour.
- **Bank Multiplier -** How much total liabilities can increase as a result of a rise in liquid assets.
- **Bank of England Act 1998** - The Act set out the statutory basis for the Monetary Policy Committee (which was formed in 1997). It passed the responsibility for supervision of banks and financial institutions from the Bank to the Financial Services Authority and responsibility for the management of the National Debt was passed to the Debt Management office (an agency of HM Treasury).
- **Bank of England Core Purposes -** The Bank has three core purposes. Firstly, to maintain the integrity and value of the currency. This mainly means maintaining price stability (low inflation). Secondly, to maintain the stability of the financial system, both domestic and international. This requires close monitoring of all events that may affect financial stability. Thirdly, to seek to ensure the effectiveness of the UK's financial system.
- **Bank of England -** The Central Bank of the UK. The Bank of England is based in Threadneedle Street in the City of London. In 1997 the Labour government gave them operational independence and they are now responsible for the maintenance of price stability. They set interest rates (through the Monetary Policy Committee) to ensure they meet the inflation target set by the government.
- **Banking Department -** That part of the Bank of England which carries out banking functions for the government and for the banking sector.
- **Barriers to Entry** - Obstacles to the entry of new firms into a market. They may be technical barriers, legal barriers or barriers that arise from strong branding of the product.
- **Barriers -** Factors inhibiting the free movement of resources e.g. restrictive laws relating to the movement of goods, capital and labour.
- **Barter -** The direct exchange of goods and services without the use of money.
- **Base Rate -** The rate of interest on which financial institutions base their lending rates. It is also used to set all their other interest rates. Their loan rates will be a certain percentage above the base rate, and their savings rates below the base rate.
- **Base Year -** The year in which calculations, usually indexes, commence and with which other years

are compared.

- **Basic Prices -** Prices excluding taxes and subsidies on products.
- **Basis Point -** One hundred basis points make up a percentage point, so an interest rate cut of 25 basis points might take the rate, for example, from 3% to 2.75%.
- **Basel Accord (or Basel Capital Accord) –** the agreement adopted by the Basel Committee on Banking Supervision in 1988, and amended in 1996. It is an internationally (among the G-10 central banks) agreed set of supervisory regulations governing the capital adequacy of international banks. Capital is measured in relation to the perceived credit and market risk of the assets owned by the banks. The standards are almost entirely addressed to credit risk, the main risk incurred by banks.
- **Bear Market -** In a bear market, prices are falling and investors, anticipating losses, tend to sell. This can create a self-sustaining downward spiral.
- **Bell Curve -** This is statistically a large and random sample when measured will produce a bell curve on a bar chart where the scale measurement is along the x-axis and the total occurrences within the sample up the y-axis.
- **Benefits -** Payments from the government to people who are in need. This may because they are unemployed or there is an insufficient level of income in the household. Examples include unemployment benefits, income support and housing benefit.
- **Beta (or Beta Coefficient) –** This is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. The Beta Coefficient is a concept taken from the popular Capital Asset Pricing Model that describes an individual asset's risk as compared to the overall market. It measures how much the particular asset moves in relation to a broader index. A beta of 1.0 indicates that an asset closely follows the market. A beta greater than 1.0 indicates greater volatility than the market. Those below 1 tell us that the security moves less than the overall market index. The Financial Times all-share index or the Dow-Jones index are usually taken as proxy measurements for general market movements.
- **Bias -** How far the average statistic lies from the parameter it is estimating. Errors from chance cancel each other out in the long run, those from bias do not.
- **Bid-Ask (Bid- offer) Spread -** Bid-ask spread is the difference between the price buyers are willing to pay for an asset (bid) and the price sellers are asking for it.
- **Bilateral Aid -** official development assistance that takes place between a donor country and a recipient country.
- **BIS -** Bank for International Settlements.
- **Black Economy** - The Black economy results from production that has not been recorded through the tax system or other conventional means of recording or disclosure.
- **Black Markets -** Created when buyers and sellers meet to negotiate the exchange of a prohibited or illegal good. More generally any unofficial market in which prices are inordinately high.
- **Black-Scholes Formula -** Developed by Nobel prize winners Fisher Black and Myron Scholes, the formula prices the value of an European option on a financial asset, given its price, the exercise price, the time to maturity, the risk-free interest rate and the asset's expected standard deviation/volatility.
- **Bond -** A promissory note or debt security - or more simply an IOU issued by a debtor, such as a government agency, local government, or a corporation, to a creditor, in a fixed amount and for a specified period. An interest bearing bond is where the debtor agrees to repay the principal amount plus a given rate of interest when the bond matures. A discounted bond is sold at a discount of its face value, such that the creditor receives a given rate of return through price appreciation upon repayment of the bond at face value.
- **Boston Matrix -** A grid containing four types of product, used as a means of analysing the product range of a business. The four types of product are cash cows, dogs, problem children/wild cards and stars.
- **Brand Image -** The view held by consumers about a particular brand of good or service. The stronger the brand image the more inelastic the demand for the product is likely to be.
- **Brand Loyalty -** A situation when a consumer is reluctant to switch from consumption of a favoured good.
- **Break-Even -** The amount of goods that have to be sold at the break-even price in order for the business to make neither a loss nor a profit.
- **Break-Even Charts -** A diagram showing the total revenue and the total cost curves for a business. The break-even production level is also shown.
- **Bretton Woods System -** An arrangement of fixed (pegged) exchange rates which operated between 1945 and 1971. The system was negotiated at the Bretton Woods

conference in 1944.

- **BRIC -** Brazil, Russia, India and China.
- **Broad Money -** Includes not only assets used as a medium of exchange, but also those used as a temporary store of value – i.e. immediate and potential purchasing power. It is a definition of money that includes some less liquid types of money as well as the narrower forms of money like notes and coins. The most commonly used measure of broad money in the UK is M4.
- **The Budget -** The annual announcement of the UK government's fiscal policy changes by the Chancellor of the Exchequer. It usually takes place in March of each year. In the Budget the Chancellor will announce the tax changes he proposes for the following tax year, and also how the government plan to spend that revenue. He will also give the medium-term forecast for the economy and confirm the inflation target that the Monetary policy Committee will have to meet. The Budget is then made law by the Finance Act after debate in Parliament.
- **Budget Balance -** See general government financial account.
- **Budget Deficit -** When government expenditure exceeds government income.
- **Budget Line -** A line showing the alternative combinations of any two goods that a consumer can afford at given prices for the goods and a given level of income. If one of the prices changes, the budget line will pivot and if income changes it will shift. When combined with indifference curves, the budget line will help show consumer equilibrium for maximising utility. Also known as a consumption possibility curve.
- **Budget Surplus -** When government income exceeds government expenditure. The budget surplus in the UK used to be called the Public Sector Debt Repayment. It is now termed as a negative Public Sector Net Cash Requirement.
- **Buffer Stock Scheme -** A form of intervention to try to stabilise the price of a commodity. Stocks of the commodity are kept and sold when the price is high to try to reduce it. When the price is low further stocks of the commodity are bought.
- **Building Societies -** Financial institutions which offer a range of services but which specialise in providing loans (mortgages) for house purchase. Building Societies have mutual status and the deregulation of the financial sector in the mid 1980s has led to many of them converting into PLCs, losing their mutual status.
- **Bull Market -** A bull market is one in which prices are generally rising and investor confidence is high. This can create a self-sustaining upward spiral
- **Business Cycle -** The tendency of economies to move, over time, through periods of boom and slump and occurs when real GDP moves away from its trend path. The business cycle is the fluctuations in the rate of economic growth that take place in the economy. It is the aim of all governments to try to dampen the effects of the business cycle and get more balanced long-term growth. The peak of the business cycle is usually referred to as a boom, and the trough as a recession or depression.
- **Business Sector Output -** Total economic output of the economy less the activities of the general government sector: that is general government consumption and gross capital formation.
- **Buyer's Market -** The quantity of goods for sale exceeds the amount consumers are willing and able to buy at the current market price. Characterised by low prices.
- **Canons of Taxation** - A set of criteria developed by Adam Smith that could be used to judge whether or not a tax was a "good" tax. They were: (1) The cost of collection must be low relative to the yield; (2) The timing and amount to be paid must be certain to the payer; (3) The means and timing of payment must be convenient to the payer;(4) Taxes should be levied according to ability to pay.
- **Capacity -** The degree of use of factors of production. Full capacity means full use of the factors of production.
- **Capital Account -** The capital account consists of capital transfers and acquisitions/disposal of non-produced, non-financial assets (such as fixed assets or inventories). It shows the redistribution of capital assets between sectors of the economy and the rest of the world.
- **Capital Accumulation -** An increase in the stock of capital goods.
- **Capital Adequacy Rules -** The minimum amount of capital (equity) that institutions must hold relative to their assets set by financial market regulators. These rules are designed to ensure that capital is sufficient to absorb likely losses.
- **Capital Assets Pricing Model (CAPM)** – this is an economic model for valuing stocks and securities as well as derivatives (see Derivatives Market) by relating risk and expected return. The model says that the expected return investors would demand is equal to the rate on a risk free security plus a

risk premium. The model is used in finance to determine a theoretically appropriate required rate of return (and thus the price if expected cash flows can be estimated) of an asset, if that asset is to be added to an already well-diversified portfolio, given that asset's non-diversifiable risk. The CAPM formula takes into account the asset's sensitivity to non-diversifiable risk (also known as systematic risk or market risk), in a number often referred to as beta (β) in the financial industry, as well as the expected return of the market and the expected return of a theoretical risk-free asset.

- **Capital Consumption -** A reduction in the stock of capital goods resulting from capital goods becoming obsolete. It may also be referred to as depreciation.
- **Capital Expenditure -** Spending by firms on capital equipment, also termed investment.
- **Capital Flight -** The movement of financial assets out of a country in response to unfavourable domestic circumstances.
- **Capital Fulcrum Point (CFP)** - the CFP measures the annual percentage growth rate required from the underlying instrument to do equally well in terms of capital appreciation from its associated warrant.
- **Capital Gain or Loss -** Increase or decrease in the value of an asset. Increases of over a certain threshold will be subject to Capital Gains Tax.
- **Capital Goods -** Goods used in the production of other goods and services.
- **Capital Inflows -** The movement of money into the UK, e.g. the purchase of shares, the purchase of companies and loans by overseas companies.
- **Capital Intensive -** A production technique which uses a high proportion of capital to labour.
- **Capital Markets -** Markets dealing in long term loans.
- **Capital Output Ratio -** The ratio that shows the amount of units of capital that are needed to produce a certain level of output.
- **Capital Transaction Account -** The standard account relating to the transactions of the nation with the rest of the world in respect of financial assets and liabilities and other sources of the finance of gross accumulation.
- **Capital Transfers -** Unrequited transfers which are designed to finance the gross capital formation, other forms of accumulation, or long-term expenditure of the recipient.
- **Capital -** The wealth - cash or other assets - used to fuel the creation of more wealth. Within companies, often characterised as working capital or fixed capital.
- **Capitulation -** Used of the stock markets, the point when a flurry of panic selling induces a bottoming out of prices.
- **Carry Trade (Currency) -** Typically, the borrowing of currency with a low interest rate, converting it into currency with a high interest rate and then lending it. The element of risk is in the fluctuations in the currency market.
- **Cartel -** A group of producers who act together to fix price, output or conditions of sale.
- **Cash Cows -** Products that produce a large amount of revenue because they have a large share of an existing market which is only expanding slowly. See Boston Matrix.
- **Cash Flow -** A record of an organisation's cash income and cash payments in a given period of time.
- **Cash Ratio Deposits -** All financial institutions who take deposits from customers are required to keep a proportion of their liabilities as a cash ratio deposit.
- **Causal Unemployment -** Those out of work in between short periods of employment.
- **Census -** The collection of information about all units in a population, sometimes also called a 100% sample survey.
- **Central Banks -** Banks which act as bankers to the government and the banking sector.
- **Central Government -** All departments, offices, establishments and other bodies classified under general government, which are agencies or instrument of the central authority of a country, except separately organised social security funds.
- **Central Planning -** State allocation of resources and setting of production targets and growth rates.
- **Central Projection -** A projection of the most likely outcome, but not always one where risks are considered evenly spread on the upside and the downside.
- **Certificate of Deposit (CD) -** A form of interest bearing time deposit which cannot be withdrawn before a specified maturity date without being subject to an interest penalty. They are used as a way of trading money between financial institutions.
- **Ceteris Paribus -** All other influencing factors are held constant. Generally used to refer to supply and demand functions to show that demand and supply curves are drawn with all other

determinants held constant.

- **Chain of Command -** The way power is passed down through a business organisation.
- **Chain of Distribution -** The link between raw material suppliers, manufacturers, wholesalers and retailers.
- **Chain of Production -** Shows the different stages of making, distributing and selling a good or service.
- **Chained Index Weighting -** An alternative way of weighting together the sub-aggregates that form GDP. The key difference to the fixed-weight aggregation, used in most countries, is that the prices are continuously updated and that "substitution bias" is avoided and that measures are independent of the choice of base year.
- **Chain-Linking -** A method of constructing an index series from two or more index series of different base periods or different weights.
- **Chapter 11** - the term for corporate bankruptcy protection in the US, similar to company voluntary arrangements (CVAs) in the UK. It postpones a company's obligations to its creditors, giving it time to reorganise its debts or sell parts of the business.
- **CIF Value -** The value in the market at the customs frontier of a country of her imports of merchandise, other goods, etc., including all charges for transporting and insuring the goods from the country of export to the given country but excluding the cost of unloading from the ship, aircraft, etc., unless it is borne by the carrier.
- **Circular Flow of Income -** The flow of income and payments between consumers and producers.
- **Classical Economics -** Classical theories revolved mainly around the role of markets in the economy. If markets worked freely and nothing prevented their rapid clearing then the economy would prosper. Any imperfections in the market that prevented this process should be dealt with by government.
- **Closed Economy -** An economy which does not engage in international trade.

  Cluster Sampling - A sampling technique where the entire population is divided into groups, or clusters, and a random sample of these clusters are selected.
- **Coase's Theory -** The belief that externalities can be accounted for in a production process by the consumer of an externality agreeing a price with the producer first.
- **Collateralised Debt Obligations (CDOs) -** A collateralised debt obligation is a financial structure that groups together individual loans, bonds or assets in a portfolio, which can then be traded. In theory, CDOs attract a stronger credit rating than individual assets due to the risk being more diversified. But, as the performance of some assets has fallen, the value of many CDOs has also been reduced.
- **Contagion (or to be more precise, Financial Contagion) –** this is the transmission of economic shocks from one country to others, through trade or other economic connections. Financial interdependence can transmit a crisis from one country to another, for example if countries borrow from the same creditors. Faced with a crisis in one country, banks and other lenders may lose their nerve and start recalling loans made to borrowers in the region, creating a credit crunch - a shortage of cash - in debtor countries. Contagion can take place both during "good" times and "bad" times and does not need to be related to crises. However, contagion tends to be emphasised only during times of crisis.
- **Collusion -** Agreements between firms to restrict competition.
- **Collusive Oligopoly -** When several large firms in an industry act to restrict price or output.
- **Colonisation -** The process of a country being taken over and becoming a colony of another.
- **Command Economy -** State allocation of resources and setting of production targets and growth rates.
- **Commercial Bank -** An organisation that provides a variety of banking services such as loans and savings schemes.
- **Commercial Paper -** Unsecured, short-term loans issued by companies. The funds are typically used for working capital, rather than fixed assets such as a new building.
- **Committee of the Regions -** A European institution that aims to ensure that the interests of local government in each of the member countries are heard by the EC.
- **Committee of Ministers -** The Council of Europe's decision-making body. It comprises the Foreign Affairs Ministers of all the member states, or their permanent diplomatic representatives in Strasbourg. It is both a governmental body, where national approaches to problems facing European society can be discussed on an equal footing, and a collective forum, where Europe-wide responses to such challenges are formulated. In collaboration with the Parliamentary Assembly, it is the guardian of the Council's fundamental values, and

monitors member states' compliance with their undertakings.

- **Commodities -** Products that, in their basic form, are all the same so it makes little difference from whom you buy them. That means that they have a market price. Commodities include such things as coal, oil, metals and precious metals.
- **Common Agricultural Policy (CAP) -** The policy whereby the European community stabilise market prices for farm goods through intervention e.g. buying up wheat if the price falls below the minimum allowed.
- **Common External Tariff (CET) -** The tariff that is charged at the same level by all members of the European Union customs union.
- **Common Market -** A customs union which permits the free movement of capital and labour between member states.
- **Commonwealth of Independent States (CIS) -** Initially made up of Russia and the other newly independent states of the former Soviet Union.
- **Comparative Advantage -** When a country produces a good or service at a lower opportunity cost than its trading partners.
- **Competition and Credit Control -** An important paper published by the Bank of England in 1971. It set out new monetary control arrangements. A system of reserve requirements was implemented and there was an end to collusion by banks on setting interest rates. The aim was to create greater competition in financial markets and use interest rates more to control the level of credit.
- **Competition Based Pricing -** When prices are determined by what a competitor is doing or plans to do.
- **Competition Policies -** Antitrust and related policies designed to foster or restrict competition.
- **Competitive Advantage -** A firm has a lower cost structure than a rival, and so can sell at a lower price or make a bigger profit at the same price.
- **Competitive Markets -** Markets where firms are generally free to enter or leave a market.
- **Competitiveness -** A measure of a country's advantage or disadvantage in selling its products in international markets. The OECD Secretariat calculates two different measures of competitiveness based on the differential between domestic and competitors' unit labour costs in manufacturing and consumer prices both expressed in a common currency.
- **Complementary Goods -** Two goods jointly bought by consumers, e.g. cars and petrol. An increase in the demand for one will cause an increase in the demand for the other.
- **Composite Demand -** When goods or commodities are demanded for two or more uses. For instance, milk can be used to make yoghurt and cheese.
- **Concentration Ratios -** Measure the proportion of an industry's output or employment accounted for by the largest firms. A 5 firm concentration ratio of 75% would indicate that the five largest firms had a total market share of 75%.
- **Concessional Terms -** A loan (e.g. overseas loan aid) that is made at more favourable terms that could be obtained commercially.
- **Conditions of Demand -** Factors held constant when considering demand, e.g. income and tastes.
- **Conditions of Supply -** Factors held constant when considering supply, e.g. costs and objectives.
- **Consolidation (of Government Debt) -** A means of presenting government accounts where a liability of a government-sector agency and institution is held as an asset somewhere else in the government sector.
- **Constant Prices -** Values that are expressed in such a way as to enable comparisons to be made across a period of years. To measure real national income, economists value total production in each year at a constant set of prices that applied in a chosen base year.
- **Consumer Adjustment -** Changes in consumer expenditure undertaken to increase total satisfaction.
- **Consumer Durables -** Goods acquired by households which have an expected lifetime of more than one year and a relatively high value.
- **Consumer Equilibrium -** Where the marginal utility/price ratios are equal for all goods the consumer is consuming so maximising satisfaction.
- **Consumer Expenditure -** Spending by households on goods and services.
- **Consumer Loyalty -** Attachment by consumers to particular goods and services.
- **Consumer Prices Index (CPI) -** The main UK domestic measure of inflation for macroeconomic purposes. It measures the average change from month to month in the prices of consumer goods and services purchased in the UK.
- **Consumer Sovereignty -** The power of consumers to determine what goods

and services are produced.

- **Consumer Surplus -** Occurs when people can buy a good for less than they are willing to pay.
- **Consumer Taste -** People's preferences for particular goods and services.
- **Consumption -** Expenditure by households on goods and services which satisfy wants.
- **Consumption Function -** A graph showing how much will be spent by households at different income levels.
- **Consumption of Fixed Capital -** The value of the reproducible fixed assets, at current replacement cost, that is used up as a result of normal wear and tear, foreseen obsolescence and the normal rate of accidental damage.
- **Contestable Markets -** Markets in which costs of entry and exit are low.
- **Continuous Data -** A set of data is said to be continuous if the values / observations belonging to it may take on any value within a finite or infinite interval, e.g. height, weight etc.
- **Continuous Random Variable -** A variable which takes an infinite number of possible values.
- **Contribution Pricing -** The difference between the price charged and the variable costs involved in producing a good so that a contribution is made towards fixed costs.
- **Convergence Criteria** - The five conditions set that countries had to meet if they wanted to take part in full economic and monetary union in the EU. They were: (1) Inflation - no more than 1.5% above the average inflation rate of the lowest three inflation countries in the EU; (2) Interest Rates - the long-term rate should be no more than 2% above the average of the three countries with the lowest inflation rates; (3) Budget Deficit - no more than 3% of GDP; (4) National Debt - no more than 60% of GDP; (5) Exchange Rates - currency within the normal bands of the ERM with no re-alignments for at least 2 years.
- **Conversion Rate -** The rate at which one currency is converted to another.
- **Co-operative -** a business owned and operated by its members.
- **Corporate Enterprises -** Defined as corporations, joint stock companies, co-operatives, limited liability partnerships and other financial and non-financial enterprises which by virtue of legislation, administrative regulations or registration, are recognised as business entities independent of their owners.
- **Corporation Tax** - A tax on company profits. It is charged as a percentage of a company's taxable profits.
- **Correction -** A short-term drop in stock market prices. The term comes from the notion that, when this happens, overpriced stocks are returning back to their "correct" values.
- **Correlation –** Two random variables are said to be positively correlated if high values of one are likely to be associated with high values of the other. They are negatively correlated if high values of one are likely to be associated with low values of the other. A number of different coefficients are used for different situations - the best known correlation coefficient is the *Pearson product-moment correlation coefficient*, which is obtained by dividing the covariance of the two variables by the product of their standard deviations.
- **Correlation Coefficient -** A measure of the degree to which two variables tend to move together. The coefficient has a value between plus and minus 1, which indicates the strength and direction of association.
- **Cost Based Pricing -** When an organisation adds a percentage mark-up on its products.
- **Cost Benefit Analysis -** A method of assessing investment projects which takes into account social costs and benefits.
- **Cost Curve -** A curve that plots costs against output.
- **Cost Effectiveness Principle -** This concerns itself with finding the least cost method of achieving a given economic aim.
- **Cost of Living -** The general level of prices in the economy usually measured by the Retail Price Index.
- **Cost Plus Pricing -** Setting prices by adding a profit margin to average cost.
- **Cost Push Inflation -** When a cost of production (e.g. wages) increases and firms put up prices to maintain profits. Cost increases may happen because wages have gone up or because raw material prices have increased. Cost-push inflation happens when costs have risen independently of demand.
- **Cost-Benefit Analysis (CBA) -** A method of assessing the social costs and benefits of an investment project.
- **Costs of Production -** Total costs are made up of fixed costs and variable costs. Total costs can also be split into direct and indirect costs.
- **Council of the European Union -** The main decision-making body of the European Union. The ministers of the Member States meet within the Council

of the European Union. Depending on the issue on the agenda, each country will be represented by the minister responsible for that subject (foreign affairs, finance, social affairs, transport, agriculture, etc.).

- **Counter-Cyclical Demand Management Policies -** Policies that are intended to manage the level of demand. The policy stance is opposite to the point in the economic cycle. In other words, if the economy is booming, then policy is fundamentally deflationary to prevent over-heating. If the economy, however, is in recession then the government's policy stance should be reflationary to kick-start the economy out of recession.
- **Counter-Trade -** The international exchange of goods and services based on barter.
- **Country Classification -** Groupings of countries used by the OECD Secretariat.
- **Court of Directors of Bank of England -** The Court of Directors is responsible for the overall management of the Bank. It sets the objectives and strategy of the Bank and is responsible for ensuring that the financial position of the Bank is properly represented in its accounts. The Court is made up of 16 non-executive directors, the Governor and the two Deputy Governors.
- **Crawling Peg -** Form of adjustable peg where the central parity can be changed regularly on the basis of the previous trend in the exchange rate.
- **Credit Creation Multiplier -** Shows increase in total liabilities as a result of a rise in liquid assets.
- **Credit Creation -** The ability of the banking sector to create money by giving advances.
- **Credit Crunch -** The situation created when banks hugely reduced their lending to each other because they were uncertain about how much money each of them had. This in turn resulted in more expensive loans and mortgages for ordinary people.
- **Credit Default Swap -** A swap designed to transfer credit risk, in effect a form of financial insurance. The buyer of the swap makes periodic payments to the seller in return for protection in the event of loan default.
- **Credit Squeeze -** A government policy which seeks to lower demand by reducing bank lending.
- **Creditor Nation -** Those nations that have a balance of payments surplus.
- **Cross Elasticity of Demand -** Measures the responsiveness of demand for good A to a given change in the price of good B. It is an important piece of information to a firm as it helps them to predict how much the demand for their product will change as the price of other goods change.
- **Cross-Correlation of Business Cycles -** A measure of how closely aligned the timing of movements in activity are for two countries over their business cycles. The closer the value is to 1 the more synchronised the business cycles will be. A value of -1 would indicate that the two series move in a counter-cyclical direction. A value near zero indicates that there is no statistical relationship between the series.
- **Crowding Out -** A decline in private sector spending resulting from a rise in public sector expenditure.
- **Currency Peg -** A commitment by a government to maintain its currency at a fixed value in relation to another currency. Typically this is done by the government buying its own currency to force the value up, or selling its own currency to lower the value.
- **Current Account Balance -** A record of a country's earnings from the sale of visible and invisible items minus its expenditure on visible and invisible items from abroad.
- **Current Account Deficit -** When a country spends more on visible and invisible items from abroad than it earns from the sale of visible and invisible items.
- **Current Account Equilibrium -** When a country's earnings from visible and invisible items match its expenditure on visible and invisible items from abroad.
- **Current Account Surplus -** When a country receives more in revenue from the sale of visible and invisible items than it spends on visible and invisible items from abroad.
- **Current Account -** National Accounts definition: current accounts deal with production, distribution of income and use of income. Balance of Payments definition: account of transactions in respect of international trade in goods and services, income and current transfers.
- **Current Prices -** The actual or estimated recorded monetary value over a defined period for a group of industries or products.
- **Customs Union -** A group of countries which removes tariff barriers between member countries and also imposes common external tariffs on non-members.
- **Cycles -** Fluctuations in economic activity which impact across many sectors. The length of the business cycle, from the top of one peak to the

next, varies from 5 to 10 years.

- **Cyclical Component -** In weekly or monthly data, the cyclical component describes any regular fluctuations.
- **Cyclical Unemployment -** Sometimes called mass or demand deficient unemployment. Workers are without a job because of a lack of aggregate demand due to a down turn in economic activity.
- **Dark Pools of Liquidity** (also **Dark Pools** or **Dark Liquidity**) **–** these are electronic "crossing networks" that provide liquidity that is not displayed on order books. They offer institutional investors and larger hedge funds many of the same benefits associated with making trades on the stock exchanges' public limit order books - without tipping their hands to others, meaning publicly quoted prices aren't affected. Dark pools range from completely opaque to semi-transparent and their order flow can range from transient to stationary. Opaqueness impacts fairness, as the more-transparent the liquidity pool, the easier it is to be manipulated. More-transparent crossing networks (such as Liquidnet Inc., Pipeline, or the SIGMA X unit of Goldman Sachs) solve this problem by not letting brokers or more-active traders onto the platform and by policing their community and evicting poachers. Other crossing engines with some transparency, such as Pipeline or Posit, give away such limited information that is difficult to use. These "pools" are growing rapidly, both in number and in volume of trades and account for around 12% of all US stock trades (Source: August 2008, Tabb Group).
- **Dead Cat Bounce -** A short-lived recovery of share prices in a falling stock market.

  Debentures - Long term fixed interest loans to companies.
- **Debt for Equity Swap -** A mechanism where indebted countries swap shares in domestic firms for private foreign debt.
- **Debt for Nature Swap -** A mechanism where foreign debt is exchanged for domestic debt enabling resources to be released to finance environmental conservation.
- **Debt Service Ratio -** The ratio of interest and principle payments as a proportion of exports for a given year.
- **Debt Service -** The total amount of interest payments and repayments of principal on external public debt.
- **Debt-Equity Ratio -** Total liabilities of a firm divided by total shareholder equity.
- **Debt for Equity Swap –** This is a way in which a company can swap some of the money it owes to a bank or other creditor in exchange for shares and, in doing this, the debt is reduced accordingly. There are many possible reasons why a company would wish to restructure its finances – such as the need to meet certain contractual obligations (for example) maintaining a debt/equity ratio below a certain number. A debt for equity swap can help a company that is in financial trouble by cancelling some of its outstanding debt.
- **Debtor Nation -** A country with a balance of payments deficit.
- **Decoupling -** Removing the dependence of an economy's success on the economies of other countries. Generally used to refer to the decoupling of the BRIC economies from the United States.
- **Decreasing Returns -** When the addition of a variable factor of production results in a fall in marginal product. Diminishing returns refers to a situation where a firm is trying to expand by using more of its variable factors, but finds that the extra output they get each time they add one gets progressively less and less. This usually arises because their capacity is limited in the short-run and the combination of the fixed and variable factors becomes less than optimal.
- **Deficiency of Aggregate Demand -** The potential level of output exceeds total planned expenditure, at the full employment level of national income. More generally, people are not spending enough to keep everyone in work.

  Deflate – Deflate means to reduce the level of economic activity. This is most likely to be necessary because there is an excess level of demand and this is leading to demand-pull inflation.
- **Deflation -** The downward price movement of goods and services.
- **Deflationary Gap -** When there is insufficient demand for goods and services to generate full-employment.
- **Deflator -** A price index used to produce a set of volume measures from a set of current values. Constant price data are normally calculated by dividing current price data by the deflator.
- **Deindustrialisation -** A sustained decline in the manufacturing sector of the economy.
- **Delors Report -** This 1988 report set out the steps towards economic and monetary union and the creation of a single currency. It was fundamental in paving the way for the Maastricht Treaty.
- **Demand and Supply Analysis -** The

study of consumer and producer behaviour with regard to price, involving the application of changes to the demand and supply conditions.

- **Demand Based Pricing -** Deciding the price to charge based on what consumers are prepared to pay.
- **Demand Curve -** A graph which shows the amount of a good that consumers are willing and able to buy at various prices. A normal demand curve is downward sloping due to the law of demand which states that as the price rises the demand for the product will fall, assuming consumers have a fixed income.
- **Demand Deposits -** Funds deposited at a depository institution that are payable on demand (immediately or within a very short period).
- **Demand For Money -** The demand to hold wealth in the form of notes, coins and sight deposits rather than in the form of e.g. government bonds, shares, antiques etc
- **Demand Management Policies -** Policies where the government is aiming to do the opposite to the trade cycle; often called 'counter-cyclical demand management policies'.
- **Demand Pull Inflation -** Occurs when there is an excess level of demand in the economy causing prices to rise: essentially 'too much money chasing too few goods.'
- **Demand -** The want or need or desire for a product that is backed by an ability to pay, measured over a given time period. It is determined by a number of factors including income, tastes and the price of complementary and substitute goods.
- **Demand-deficient Unemployment -** May also be referred to as cyclical unemployment, it arises when people are out of work because of a lack of aggregate demand. It will tend to happen mainly in recessions or downturns in the trade cycle.
- **Demerger -** A demerger happens when a firm either divides into two or more firms or sells off some of its subsidiaries.
- **Demerit Goods -** A product, such as alcohol, which consumers may overvalue but which the government believes may be harmful for consumers.
- **Demographic Transition -** Changes in population growth rates over time due to changes in birth and death rates.
- **Demographics -** The study of trends in population.
- **Dependancy Ratio -** The ratio of dependant population (the young and the elderly) to the working age population.
- **Dependant Population -** People who do not work e.g. children and the retired and who rely on others for the goods and services they consume.
- **Deposit Accounts -** Money held in banks or building societies which earn interest but which are subject to a period of notice before withdrawal.
- **Depreciation of Currency -** When the value of one currency, expressed in terms of anther currency, falls.
- **Deregulation -** The removal of controls on a particular market aimed at improving the economic efficiency of that market and therefore the performance of the economy at the microeconomic level.
- **Derivative Security -** A security whose value depends on the value of other basic underlying securities. Examples are futures and options, forward contracts, swaps and other types of options. Derivatives can be used as insurance to limit the risk of a particular investment. Credit derivatives are based on the risk of borrowers defaulting on their loans.
- **Derived Demand -** Where the demand for goods A depends on the demand for goods B, e.g. an increase in the demand for houses creates a direct demand for bricklayers.
- **Devaluation of Sterling -** When the UK government lowers the value of the £ from one fixed rate to another.
- **Developed Countries -** Countries with high levels of real national income per head and relatively large tertiary sectors.

Developing Countries - Countries with low levels of real national income per head and relatively large primary sectors.

- **Development Trap -** The vicious cycles of poverty that prevent a country from developing.
- **Development -** Increase in the ability of a country to produce goods and services thereby offering the opportunity for a higher material standard of living.
- **Differentiated Products -** Goods or services which are distinguished from rival products by e.g. packaging, advertising.
- **Differentiation -** A strategy which offers the same goods at different prices for different sectors of the market.
- **Diminishing Returns -** When the addition of a variable factor of production results in a fall in marginal product. Diminishing returns refers to a situation where a firm is trying to expand by using more of its variable

factors, but finds that the extra output they get each time they add one gets progressively less and less. This usually arises because their capacity is limited in the short-run and the combination of the fixed and variable factors becomes less than optimal.

- **Direct Costs -** All the costs that are associated with the production of a service or good.
- **Direct Taxation -** Taxes on income and wealth. The main direct tax in the UK is income tax.
- **Directives -** Instructions from Europe to individual EC countries to meet particular objectives.
- **Dirty Floating -** Government attempts to influence the value of a floating exchange rate in order to gain a competitive advantage.
- **Disbursement -** The transfer of financial resources and or good and services from a donor to a recipient country.
- **Discount Houses -** Financial institutions which borrow short and lend long. They used to act as an intermediary between the Bank of England and the banking system.
- **Discount Rate -** The interest charged by a central bank on loans to domestic financial institutions.
- **Discounted Cash Flow -** A method of assessing a project which takes into account the timing of receipts and payments. Discounted cash flow techniques take the future returns and discount them using a 'discount rate' to see what they would be worth today.
- **Discrete Data -** A set of data is said to be discrete if the values/observations belonging to it are distinct and separate.
- **Discrete Variable -** A variable that takes only a finite number of real values, e.g., 1, 3, 5 etc.
- **Discretionary Policy -** Deliberate changes in government expenditure and/or taxes.
- **Discriminating Monopoly -** A sole producer who divides up the market and charges different prices to different groups of customers.
- **Diseconomies of Scale -** Increases in long run costs which occur from an increase in the scale of production.
- **Disequilibrium Unemployment -** When the aggregate demand for labour is less than the aggregate supply of labour at the current real wage rate.
- **Disposable Income -** The amount of income left after such deductions as income tax, pension contributions and national insurance: 'take home pay'.
- **Dissaving -** Spending more than income by drawing on savings.
- **Distribution of Income -** How income is shared out between households and between factors of production.
- **Disutility -** The amount of satisfaction obtained by consuming extra units of a good falls.
- **Dividends -** A payment by a company to its shareholders, usually linked to its profits.
- **Division of Labour -** The breaking down of a task into small, separate operations each performed by just one operator.
- **Dog -** A product with low growth and low market share. See Boston Matrix.
- **Domestic Factor Incomes -** The compensation of employees and operating surplus originating in domestic production; in other words, included in the valued added of resident producers.
- **Double Counting -** Including transfer payments, intermediate expenditures or outputs and stock appreciation in national accounts.
- **Dual Exchange Rate -** A system where there is a fixed official exchange rate and an illegal market determined parallel exchange rate. often occurs in developing countries where the value of the exchange rate is pegged.
- **Duesenberry** - James Stemble Duesenberry (July 18, 1918 – October 5, 2009) was an American economist He made a significant contribution to the Keynesian analysis of income and employment with his 1949 doctoral thesis *Income, Saving and the Theory of Consumer Behavior*.
- **Dumping -** The sale of goods in a foreign country at a price below that charged in the home market. This will often be done at below cost price to dispose of surpluses of goods, or to establish markets.
- **Duopoly -** Any market that is dominated by two organisations.
- **Dynamic Asian Countries -** Country grouping comprising Chinese Taipei; Hong Kong China; Indonesia; Malaysia; the Philippines; Singapore and Thailand.
- **Earnings Per Share -** A company's profit divided by the total shares outstanding.
- **ECOFIN -** A European council made up of the Ministers of Finance of member countries that looks at economic and monetary policy in the European Union.
- **Economic and Monetary Union (EMU) (also short for European Economic and Monetary Union) -** The process which enabled the

introduction of the EU's single currency, the euro.

- **Economic Efficiency Principle -** The principle of seeking to provide what consumers most require or the principle of producing every product at the least possible cost.
- **Economic Growth -** Typically refers to an increase in a country's output of goods and services. It is usually measured by changes in real GDP.
- **Economic Problem -** While our resources are finite, our wants and needs are infinite.
- **Economic Rent -** The difference between what a factor of production is earning (its return) and what it would need to be earning to keep it in its present use, i.e. the amount a factor is earning over and above what it could be earning in its next best alternative use (its transfer earnings).
- **Economic Union -** A common market whose members follow common economic policies.
- **Economic Welfare -** The study of how an economy can maximise the utility of its inhabitants.
- **Economies of Scale -** A reduction in long run unit costs which arise from an increase in production. This occurs when larger firms are able to lower their unit costs e.g. by buying in bulk or raising capital cheaper.
- **Effective Exchange Rate -** The exchange rate of the domestic currency vis-à-vis other currencies weighted by their share in either the country's international trade or payments. Also called the trade-weighted exchange rate and expressed as an index number.
- **Elasticity of Demand -** The responsiveness of demand to a change in a determinate, for instance, price, price of other goods and income.
- **Elasticity of Supply**
  The responsiveness of supply to a given change in price.

  Elasticity - The responsiveness of one variable to changes in some other variable.
- **Elliott Wave Theory -** A technical analysis technique published by Ralph Elliott, which claims that stockmarkets follow a pattern of five waves up and three waves down (or sometimes, five up and three down in a bull market, and three up and five down in a bear market). According to Elliott, stockmarket movements conform to specific patterns, consisting of a series of waves – because people tend to think and behave in a herd-like way (i.e., people’s response to price changes isn’t reasoned or random, but is determined by “shared mood trends”). Every wave consists of a number of smaller waves conforming to the same pattern, so it is possible to discern Elliott Waves in price movements during an hour or a century.
- **Embargo -** When a ban is placed on the export or import of a certain good or on trade with a particular country or countries.
- **Empirical -** Real world evidence. Empirical studies are undertaken to try to prove theories and assertions.
- **Engel curve -** A curve showing the relationship between income and consumption.
- **Enterprise -** A term used to refer to entrepreneurial skill. It is the skills and ability to take risk and create profit.
- **Entrepreneurs -** People who undertake the risks of production in order to make a profit.
- **Equilibrium Price -** The price where the quantity supplied by firms equals the quantity demanded by households: there is no shortage or surplus within the market.
- **Equilibrium Rate of Interest –** The rate at which the amount of money people want to borrow equals the amount of money others are prepared to lend.
- **Equilibrium Unemployment -** When the demand for and supply of labour at the current real wage rate are equal.
- **Equity (Fairness) Criteria -** The 'desirability' of a particular resource allocation.
- **Equity -** In a business, equity is the total value of the shares. In a house, equity is the value minus the amount of mortgage debt that is outstanding on it.
- **European Union (EU)** - Comprises 27 countries: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the UK. The EU was established by the Treaty of Maastricht in 1993.
- **Euro Area -** The 16 EU countries that by 2009 have adopted the Euro (Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia and Spain).
- **Eurocurrency -** Any currency deposited in a financial institution outside its country of origin.
- **Eurodollars -** US dollar deposits held by various financial institutions outside of the United States.

- **European Central Bank (ECB) -** The bank that sets monetary policy for the eurozone.
- **European Investment Bank (EIB) -** The largest financial institution in the world. It gives loans for regional development particularly in the less developed areas of Europe.
- **European Monetary System (EMS) -** EMS seeks to stabilise exchange rates between member countries.
- **European Regional Development Fund (ERDF) -** The ERDF provides finance for projects in the poorest regions of Europe.
- **European Single Act -** This Act opened the way for economic and monetary union between the countries who took part in the EMS.
- **European Social Fund (ESF) -** The ESF supports and gives grants for training and job creation programmes. It targets particularly youth unemployment.
- **European System of Accounts (ESA) -** European System of National and Regional Accounts. An integrated system of economic accounts. The UK National Accounts have been based on the European System of National Accounts 1995 (ESA 95) since September 1998. Prior to this they were based on ESA79 which is still in use for compiling the Gross National Product.
- **European System of Central Banks (ESCB) -** The ESCB is made up of the central banks of the countries who have adopted the single currency. It administers the Union's monetary policy, the main aim being the achievement of price stability.
- **Eurostat -** The statistics office of the EC which is based in Luxembourg. It receives data from the National Statistical offices of the member countries and then unifies and publishes it.
- **Excess Demand -** When consumers want to buy more than producers are prepared to sell.
- **Excess Supply -** When producers are prepared to sell more than consumers want to buy.
- **Exchange Control -** Where the amount of foreign currency available to domestic firms and citizens is controlled by the government.
- **Exchange Equalisation Account -** A Treasury account operated by the Bank of England to buy and sell sterling to influence the exchange rate.
- **Exchange Rate Parities -** Exchange rates expressed in terms of gold or dollars.
- **Exchange Rate Target -** If a government targets the exchange rate with a low inflation country, then any increase in inflation will show as a depreciation of the currency. Interest rates can then be changed accordingly.
- **Exchange Rate -** The price of one currency in terms of another currency. Exchange rates can be fixed or floating. Fixed means that they stay at the same value as set by the government. Floating means that they fluctuate day to day according to the market. More generally the term can also refer to the price at which any good is being traded for another good.
- **Exercise Price -** The pre-specified price at which a security underlying a futures or option contract may be bought or sold on the contract’s expiration date.
- **Exit-voice Theory -** Distinguishes between different ways in which consumers may desert a market. One way is to stop buying e.g. sales of ivory.
- **Expectations -** What consumers and producers anticipate will happen to key economic variables e.g. inflation.
- **Expectations-Augmented Phillips Curve -** A Phillips curve shows combinations of unemployment and inflation at given points in time. As consumer adjust to higher anticipated levels of inflation the Phillips curve shifts to the right. The expectations-augmented Phillips Curve was developed by Milton Friedman to try to explain the breakdown of the Phillips Curve in the 1970s. He incorporated people's price expectations, and said that there would be a number of short-run Phillips Curves - one for each level of price-expectations. However, in the long-run there would be no trade-off between unemployment and inflation and any attempt to reduce unemployment to below its natural rate would simply be inflationary.
- **Expenditure Switching -** Policies designed to switch spending from overseas goods to domestic goods.
- **External Benefits -** The spillover advantages of production or consumption for which no money is paid by the beneficiary e.g. the sight of a well kept garden.
- **External Constraints -** Factors beyond the control of a consumer or firm which influence economic behaviour.
- **External Costs -** Negative spillover effects of production or consumption for which no compensation is paid e.g. pollution.
- **External Debt -** The total amount of

private and public foreign debt owed by a country.

- **External Diseconomies of Scale -** The disadvantages firms experience in the form of higher long run average costs as a result of an industry growing in size.
- **External Growth -** When a firm increases its size by taking over or merging with another firm.
- **External Liabilities -** Movements of money into the UK on the capital account of the balance of payments.
- **External Shocks -** Unexpected adverse change to an economic variable which takes place outside a given economy. For example, a rise in the price of oil caused by war.
- **Factor Cost -** The value of output measured in terms of the cost of the factors of production used to produce it.
- **Factor Endowments -** The resources which a country possesses e.g. land, labour, capital.
- **Factor Immobility -** Barriers to the movement of land labour and capital.
- **Factor Incomes -** Compensation of employees by, and operating surplus of, producers.
- **Factor Mobility -** The ability of land, labour or capital to be put to an alternative use or moved to another location.
- **Factors of Production** - Resources that are necessary for production usually classified into 4 different group. The rate of economic growth that an economy can manage will be affected by the quantity and the quality of their factors of production: (1) Land - all natural resources (minerals and other raw materials); (2) Labour - all human resources; (3) Capital - all man-made aids to production (machinery, equipment etc); (4) Enterprise - entrepreneurial ability. The rate of economic growth that an economy can manage will be affected by the quantity and the quality of the factors of production they have.
- **Family -** Consumers who have children still living at home.
- **Fiduciary Issue -** The issue of notes and coins that are not backed by gold.
- **Final Consumption Expenditure -** Spending on goods and services that are used for the direct satisfaction of individual or collective needs, as distinct from purchases for use in a productive process.
- **Financial Accelerator -** Response of credit market conditions to "shocks" to the economy that may amplify and spread the effect of the shocks. For example, credit may become harder to obtain for households and firms in an economic downturn, which can make the downturn more severe and prolonged.
- **Financial Account -** National Accounts definition: the financial account shows how net lending or borrowing is achieved by financial transactions. Balance of Payments definition: the financial account records transactions in external assets and liabilities of the UK. The financial account consists of direct investment, portfolio investment, other investment and reserve assets.
- **Financial Corporations -** Corporations who are primarily engaged in financial activities e.g. banks, building societies, pension funds etc.
- **Financial Institutions -** Institutions which provide a range of services including lending, accepting deposits, providing advice.
- **Financial Intermediaries -** Institutions which channel funds from people and institutions wishing to lend to those wishing to borrow.
- **Financial Services Authority (FSA) -** The regulatory body for the financial services industry. A number of separate regulatory bodies were brought together into the FSA. The FSA also took over the responsibilities from the Bank of England for supervising banks and other financial institutions.
- **Financial Stability Committee -** A Bank of England Committee which meets monthly to monitor developments and events in financial markets in the UK and overseas.
- **First-Order Auto-Correlation -** A measure of to what extent the level of current economic activity depends upon past levels. The higher the degree of dependence the longer or more persistent the business cycle will be.
- **Fiscal Consolidation -** Policy aimed at reducing government deficits and debt accumulation.
- **Fiscal Drag -** The dragging of people into higher tax brackets when incomes rise with inflation but tax allowances/bands do not. A subtle means to raise more tax revenue.
- **Fiscal Policy -** The stance taken by government with regard to its spending or taxation with a view to influencing the level of economic activity. An expansionary (or reflationary) fiscal policy could mean cutting levels of direct or indirect tax or increasing government expenditure to encourage more spending and boost the economy. A contractionary (or deflationary) fiscal policy could be increasing taxation - either direct or indirect – or cutting government expenditure to reduce the level of demand in the economy and help to reduce inflation.

- **Fisher's Equation of Exchange -** Money supply X The velocity of circulation = Average prices X number of transactions. This is also equivalent to National Expenditure.
- **Fisher's Quantity Theory of Money -** The view that changes in the money supply have a direct and proportionate effect on the price level.
- **Fixed Assets** - Long-term assets that have a useful life of more than one year, e.g. buildings and machinery, goodwill, trademarks etc.
- **Fixed Costs -** Production expenses that are independent of the level of output, e.g. loan repayments, marketing costs.
- **Fixed Exchange Rate -** Where the value of a currency against other currencies remains exactly the same. Governments have to hold large stocks of foreign exchange, so that they can actively intervene to hold the value of the currency stable. Monetary and fiscal policies will also have to be directed to keeping the rate constant.
- **Fixed Interest Securities -** Investments that pays a fixed rate of interest e.g. gilts.
- **Flat Yield (also called Running Yield or Interest Yield)** - it is the income you earn in a year per £100 market value of a bond. The figure is calculated by dividing the coupon by the market price and multiplying by 100.
- **Floating Exchange Rate -** A currency exchange rate that is allowed to find its own value against other currencies.
- **Flotation -** The process where a business organisation offers its shares for sale on the stock market (also called IPO (initial public offering).
- **Flow Value -** An amount over a given period in time, e.g. income per year.
- **Footloose Industries -** Industries which can set up in a variety of locations without affecting production costs.
- **Foreign Aid -** The international transfer of public and private funds in the form of loans or grants from donor countries to recipient countries.
- **Foreign Capital Flows -** Financial and capital assets that flow between countries.
- **Foreign Direct Investment -** A direct investment where the foreign investor holds at least 10 per cent of the ordinary shares or voting rights in an enterprise and exerts some influence over its management. This investment is recorded as a credit in the balance of payments.
- **Foreign Exchange Gap -** When a country's balance of payments on current account deficit is greater than the value of capital inflows.
- **Foreign Exchange Reserves -** The stocks of foreign currency denominated assets plus, in a number of cases, gold, held by at a central bank.
- **Forward Contract -** An agreement between two parties for the delivery of an asset at a future date.
- **Forward Exchange Rate -** A rate for buying foreign exchange at a fixed point in the future.
- **Forward Integration -** When one firm joins another firm that is at a later stage in the chain of production.
- **Fractionalised Reserve Banking** - A system in which banks keep only a fraction of their deposits on reserve as cash and deposits at the Central Bank. In a 100 percent reserve banking system, banks would be unable to create money by making loans. However, holding less than 100 percent allows banks to make loans and, in turn, create money in the economy.
- **Free Cash Flow –** this is the amount of cash generated by the business after meeting all its operating obligations for interest, tax and dividends and after all capital investment. It shows how much money the company could pay out to shareholders without expanding and without running down its existing operations The higher a company's free cash flow yield, the better.
- **Free Goods -** Goods in unlimited supply at zero prices e.g. air.
- **Free Market Economy -** A system where resources are owned by households, markets allocate resources through the price mechanism and income depends upon the value of resources owned by an individual.
- **Free Trade -** International trade free from any restrictions such as tariffs.
- **Freeports -** Areas close to air and shipping ports into which imports are allowed without paying tariffs on the condition that they are exported.
- **Frequency Ratio -** The proportion of national tariff lines that are affected by a particular non-tariff barrier or by a specified group of non tariff barriers, irrespective of whether the products affected are actually imported.
- **Frictional Unemployment -** Sometimes called transitional, this occurs when unemployed workers are temporarily without a paid occupation while moving from one job to another. The more efficiently the job market is matching people to jobs, the lower this form of unemployment will be. Where there is imperfect information and people don't get to hear of jobs available that may suit them then frictional unemployment will be higher.

- **FTSE** - Financial Times Stock Exchange, the joint operation for compilation and maintenance of the indices used as the key performance benchmarks for the UK Stock Market.
- **FTSE Index** - three indices comprise the FTSE All Share index - FTSE 100, FTSE Mid 250 & FTSE Small Cap. A fourth index, the FTSE Fledgling, covers newly listed and other listed companies not included in the other indices.
- **FTSE-100 -** An index of the 100 companies listed on the London Stock Exchange with the biggest market capitalisation - the share price multiplied by the number of shares.
- **Full Capacity -** When a firm or economy cannot produce more with existing resources.
- **Full Cost Pricing -** Where the fixed costs are allocated between all the products that are sold.
- **Full Employment Equilibrium** - This is the level at which everyone who wants to work is able to do so.
- **Functional Distribution of Income -** The distribution of income between factors of production.
- **Fundamentals -** Fundamentals determine a company, currency or security's value. For a company they include its assets, debt, revenue, earnings and growth.
- **Funding -** Where the Bank of England issues more long-term securities and fewer short term securities, thereby reducing the banks' liquid assets and reducing their ability to lend more. Funding therefore acts as a contractionary monetary policy.
- **Futures Contract -** An agreement to buy or sell a commodity at a predetermined date and price. It could be used to hedge or to speculate on the price of the commodity.
- **GATT -** The General Agreement on Tariffs and Trade. GATT was the outcome of the failure of negotiating governments to create the International Trade Organization (ITO). GATT was formed in 1947 and lasted until 1994, when it was replaced by the World Trade Organization in 1995.

GDP Deflator - The index value used to eliminate the effect of inflation. Real national income is found by dividing money national income by the GDP deflator and multiplying by 100.

- **General Government Account -** Consolidated central, state and local government accounts, social security funds and non-market non-profit institutions controlled and mainly financed by government units.
- **Geographical Immobility -** Where resources do not freely move from one location to another.
- **Geographical Mobility -** The extent to which factors of production are able and willing to move from one part of the country to another.
- **Giffen Good -** An increase in income results in a fall in demand for the good.
- **Gilt-edged Securities (Gilts) -** A form of long-term government borrowing. They are a promise to repay in the future and have a fixed term and pay a fixed level of interest. Their trading value will vary inversely with changes in the level of interest rates.
- **Goodhart's Law -** "Any observed statistical regularity will tend to collapse once pressure is placed on it for control purposes". In other words if a relationship between two variables is observed, and the government then tries to use this relationship as a policy tool, the whole relationship is likely to break down.
- **Goods in Competitive Supply -** Goods that can be produced using the same factors of production.
- **Government Capital Expenditure -** Government spending on investment goods e.g. investment in hospitals, schools, equipment and roads.
- **Government Current Expenditure -** Government day to day spending on recurring items including salaries and consumables etc.
- **Government Expenditure -** Spending by central government and local authorities on the provision of goods and services, transfer payments and debt repayments.
- **Government Financial Statistics (GFS) -** Accounting framework developed by the International Monetary Fund to provide guidelines for the compilation of fiscal accounts.
- **Government Gross Debt -** All financial liabilities of general government, mainly in the form of government bills and bonds.
- **Government Intervention -** When the state interferes with the working of an individual market e.g. through price controls.
- **Government Net Debt -** All financial liabilities minus all financial assets of general government. Financial assets of the general government sector have a corresponding liability existing outside that sector. The exceptions are monetary gold and Special Drawing Rights, financial assets for which there is no counterpart liability. Monetary gold and Special Drawing Rights may be included as assets of the general government sector or they may be classified as assets of the central bank, at the discretion of the government.

- **Grant -** A form of foreign aid that involves a direct transfer payment from one country to another.
- **Green Economics -** The study of environmental issues including the depletion of non renewable resources.
- **Green Taxes -** Taxes imposed with the objective of improving the environment.
- **Gross Domestic Fixed Capital Formation -** Total spending on fixed investment e.g. machines, factories, offices.
- **Gross Domestic Product (GDP) -** A measure of economic activity in a country, namely of all the services and goods produced in a year. It is the total value of all goods and services produced over a given time period (usually a year) excluding net property income from abroad. It can be measured either as the total of income, expenditure or output.
- **Gross Fixed Capital Formation (GFCF) -** Investment in assets which are used repeatedly or continuously over a number of years to produce goods.
- **Gross Investment -** Total investment without taking account of depreciation.
- **Gross National Product (GNP) -** A measure of UK citizens' activities all over the world. The difference between GNP and GDP is the value of any net property income from abroad.
- **Gross Value Added (GVA) -** The difference between output and intermediate consumption for any given sector/industry. That is the difference between the value of goods and services produced and the cost of raw materials and other inputs which are used up in production.
- **Gross Weekly Income -** Total weekly income before the deduction of direct taxes and additions of state benefits.
- **Growth -** Increases in total output (GDP).
- **Hard Currency -** A currency of an industrialised country that has general convertibility.
- **Hard Loan -** A loan where commercial rates of interest are changed and no concessions made to the debtor.
- **Harmonised Index of Consumer Prices (HICP) -** A comparable measure of inflation for Member States of the European Union. In the UK, the HICP is known as the Consumer Prices Index (CPI).
- **Sir Roy Forbes Harrod -** Sir Roy Harrod wrote on subjects as diverse as money, exchange rates and inflation.
- **Harrod-Domar Growth Model -** An economic model which maintains that the growth rate of GDP depends upon the level of savings and the capital output ratio.
- **Headline Rate of Inflation -** The rate of inflation unadjusted for one-off, abnormal or distorting factors.
- **Hedge Fund -** A private investment fund with a large, unregulated pool of capital and very experienced investors. Hedge funds use a range of sophisticated strategies to maximise returns - including hedging, leveraging and derivatives trading.
- **Hedging -** Making an investment to reduce the risk of price fluctuations to the value of an asset. E.g., if you owned a stock and then sold a futures contract agreeing to sell your stock on a particular date at a set price. A fall in price would not harm you - but nor would you benefit from any rise.
- **Sir John Richard Hicks -** Sir John Hicks developed the analytical tool of indifference curve analysis. He also spent time developing a macroeconomic framework to model the economy. This framework is known as IS-LM analysis, and is still a very useful tool in macroeconomics.
- **HM Treasury** - The government department responsible for economic management. The Chancellor of the Exchequer is the government minister in charge of the Treasury. The Bank of England work closely with the Treasury; the Bank sets monetary policy, while the Treasury sets fiscal policy. Monetary Policy Committee meetings have a Treasury observer present.
- **Holding Company (or Parent Company) -** A company that controls other companies.
- **Horizontal Integration -** Two companies merge in the same industry and at the same stage of production.
- **Horizontal Ratio Analysis** - Using financial ratios to provide comparison of a company's performance across a series of different financial periods (years).
- **Household and NPISH Sector -** This sector includes all residents of the UK as receivers of income and consumers of products. As well as conventional families, residential homes etc, this sector includes one person businesses where the household and business accounts cannot be separated.
- **Household Final Consumption Expenditure (HHFCE) -** Spending by the Household Sector on products or services to satisfy their immediate needs or wants.
- **Household Income -** The total level of income earned by all the households in the economy. This will be a significant part of the overall level of National

Income.

- **Household Saving -** Household sector saving as a percentage of household sector disposable income.
- **Human Capital -** The accumulated skill, knowledge and expertise of workers.
- **Human Development Index -** An index that takes into account not only the goods and services produced but also the ability of a population to use these and the time they have to enjoy them. It is a composite index based on real GDP per capita (PPP), life expectancy at birth and educational achievement that measures socio-economic development.
- **Human Poverty Index -** A composite index that measures human deprivation.
- **Hyperinflation -** Very high rates of inflation which can cause major economic problems and political instability.
- **Illiquid asset -** An asset which takes time to convert into cash.
- **Immobility of Labour -** Barriers to the movement of workers.
- **Impairment Charge -** The amount written off by a company when it realises that it has valued an asset more highly than it is actually worth.
- **Imperfect Competition -** Covers market structures between perfect competition and monopoly, i.e. an industry with barriers to entry and differentiated products.
- **Import Controls -** Government imposed limits on the entry of goods into a country.
- **Import Coverage Ratio -** The share (or percentage) of a country's own imports that is subject to a particular non tariff barrier, or any one of a specified group of non tariff barriers.
- **Import Penetration -** The proportion of domestic consumption accounted for by imports.
- **Import Quotas -** Restrictions on the quantity and or value of imports of specific commodities for some given time period, which are administered globally, selectively or bilaterally.
- **Imports -** Goods, services and capital assets purchased from overseas countries.
- **Imputed Income -** Estimated income based on opportunity cost.
- **Incentive Effect -** An encouragement to work harder resulting from a change in the rate of income tax.
- **Incidence -** How the final burden of taxation is shared out.
- **Income Determination -** How the level of economic activity is determined.
- **Income Effect -** The effect on a person's overall purchasing power resulting from a change in the price of something they normally buy.
- **Income Elasticity of Demand -** This measures the responsiveness of demand to a given change in income. It is an important piece of information to a firm as it helps them to predict how much the demand for their product will grow as the economy grows. If the income elasticity of demand is positive then the good is either normal or luxury. However, a negative income elasticity of demand implies that the good is inferior.
- **Income Tax -** Tax levied by the government on wages, rent, interest and dividends. It is collected through a set of marginal rates using bands.
- **Income-Leisure Trade-off -** The choice labour makes between working more hours or taking more leisure when the rate of income tax changes.
- **Increasing Returns -** When an addition to a variable factor of production causes marginal product to rise.
- **Independent Goods -** Two or more goods that are not consumed together e.g. pins and olives.
- **Indicator Models -** An econometric approach to estimate quarterly GDP growth from monthly data.
- **Indicators -** Variables such as the level of unemployment the rate of interest or retail sales which reflect the performance of an economy.
- **Indifference Curves -** A curve which shows all the different combination of two goods where a consumer is indifferent. In other words, the combination of two goods that gives the same level of utility.
- **Indifference Map -** A graph that shows a whole set of indifference curves. The further away a particular curve is from the origin then the higher the level of satisfaction it represents.
- **Indirect Taxation -** A surcharge on price imposed on the sale of goods and services by the government, e.g., in the UK, charged as VAT and taxes on alcohol, tobacco etc.
- **Indivisibilities -** Minimum size at which inputs, particularly capital can be used.
- **Induced Consumption -** Expenditure by households on goods and services which varies with income.
- **Industrial Production Index -** Index of production in mining, manufacturing and public utilities (electricity, gas and water), but excludes construction. The

exact coverage, the weighting system and the methods of calculation vary from country to country but the divergences are less important than e.g. in the case of the price and the wage indices.

- **Industrialisation -** The development of the manufacturing sector. In other words the process of expanding the country's capacity to produce secondary goods and services.
- **Inelastic -** One variable is unresponsive to changes in another.
- **Infant Industries -** Sunrise industries - that is industries that are at an early stage of their development.
- **Inferior Goods -** Items for which an increase in income results in a fall in the amount bought e.g. bread, linoleum and coal. These products will have a negative income elasticity of demand.
- **Inflation Target -** Since giving the Bank of England operational independence in 1997 the government have set an inflation target that the Bank of England has to meet. Interest rates are set by the Monetary Policy Committee to achieve the target which is currently 2.0%.The Governor of the Bank is required to write an open letter to the Chancellor if inflation deviates more than 1% on either side of the target value.
- **Inflation -** A sustained increase in the general price level, i.e. the rate at which prices are increasing.
- **Inflationary Gap -** This occurs when there is too much demand in the economy. This excess level of demand will tend to lead to demand-pull inflation.
- **Informal Sector -** The sector of the economy, often comprising of small businesses and individuals, which is unregistered with the tax authorities.
- **Infrastructure -** The underlying amount of physical and financial capital that is embodied in the transport, communication, energy and public services e.g. roads, railways, power stations, schools, bridges etc.
- **Injections -** An addition to the income of firms which does not normally arise from the expenditure of households e.g. changes in investment, government spending or exports.
- **Inputs -** These resources are sometimes called the factors of production i.e. land, labour, capital and entrepreneurs. More generally, it is anything which makes a contribution to a production process.
- **Institute of Fiscal Studies -** A research institute which exists to provide top quality economic analysis which is independent of government, political party or any other vested interest.
- **Instruments -** Policy tools over which the government has control and which are implemented to influence target variables.
- **Integration -** Integration occurs when two firms combine.
- **Interbank Overnight Lending Market -** A market where depository institutions buy or sell funds needed to meet a reserve requirement at the end of the trading day. In this market, banks can sell their excess reserves to other banks with insufficient reserves at the overnight inter-bank lending rate. The central bank typically serves as the institutional basis of the overnight lending market.
- **Interdependence -** When the actions of one firm has an effect on its competitors.
- **Interest Elasticity of Demand For Investment -** The responsiveness of investment to changes in interest rates.
- **Interest Rate Swap** - a transaction in which two counterparties exchange interest payment streams of differing character based on an underlying notional principal amount. More simply, interest rate swaps are simply the exchange of one set of cash flows (based on interest rate specifications) for another. The advantage to this is that one company may have access to lower fixed rates and another company may have access to lower floating rates. The three main types of swap are coupon swaps (fixed rate to floating rate in the same currency), basis swaps (one floating rate index to another floating rate index in the same currency) and cross-currency interest rate swaps (fixed rate in one currency to floating rate in another). Often, an interest rate swap involves exchanging a fixed amount per payment period for a payment that is not fixed (the floating side of the swap would usually be linked to another interest rate, often the LIBOR). In an interest rate swap, the principal amount is never exchanged: it is just a notional principal amount. Also, on a payment date, it is normally the case that only the difference between the two payment amounts is turned over to the party that is entitled to it, as opposed to exchanging the full interest amounts. Thus, an interest rate swap usually involves very little cash outlay.
- **Interest Rates -** Interest is the reward for giving up use of money and is an amount paid to a lender over and above the original sum borrowed. The rate is expressed as a % per annum. The rate of interest can be thought of as the price of money.
- **Interlink -** The OECD's world

econometric model.

- **Intermediate Consumption -** The cost of raw materials and other inputs which are used up in the production process.
- **Intermediate Expenditures -** Spending on raw materials and components.
- **Intermediate Outputs -** Output of raw materials and components.
- **Intermediate Targets -** A target that is set to help achieve a final outcome, e.g. a target could be set for the exchange rate to help reduce inflation.
- **Internal Rate of Return (IRR)** - the rate of return or discount rate used in the financial appraisal of a project which produces a net present value of cash flows equal to zero. It is a measure of a project's profitability. The IRR should exceed the cost of capital.
- **Internalised -** The monetary effects of economic activity are absorbed by the consumer, firm or themselves.
- **International Bank for Reconstruction and Development (IBRD) -** See World Bank.
- **International Development Association (IDA) -** A branch of the World Bank that offers concessionary loans to less developed countries.
- **International Labour Organisation (ILO) -** A leading analyst of labour markets. Its indicators are used domestically to make international comparisons.
- **International Monetary Fund (IMF) -** An organisation established to encourage international co-operation in the monetary field, the stabilisation of exchange rates and the removal of foreign exchange restrictions.
- **Intervention Price -** The price at which a government or the authorities managing a commodity agreement agree to purchase or sell stocks to maintain a particular price.
- **Intervention -** Any form of government interference with market mechanisms. Intervention is the act of intervening in a market to try to influence the market outcome. An example of intervention is that the Bank of England intervenes daily in the money markets to ensure that interest rates are maintained at the level set by the Monetary Policy Committee.
- **Investment Bank -** Investment banks provide financial services to governments, companies or extremely rich individuals.
- **Investment Income -** Income recorded in the balance of payments of income from foreign investments.
- **Investment -** The purchase of capital equipment. i.e. the purchase of machines, equipment, factories etc. that firms need to enable them to produce. Investment can also refer to changes in the level of stocks.
- **Invisible Balance -** The difference between a country's income and expenditure on services such as tourism and banking together with profits earned and interest payments received from overseas.
- **Invisible Hand -** A term coined by the economist Adam Smith who believed that although individuals followed their own interest the greatest benefit to society as a whole is achieved by their being free to do so.
- **Inward Oriented Development -** Government policy that attempts to achieve development by stimulating domestic industry and import substitution behind trade barriers.
- **IS-LM -** A model of income determination that integrates the goods market (represented by investment and saving) and the money market (demand and supply of money).
- **Issue Department -** That part of the Bank of England which has responsibility for the issue of bank notes.
- **J Curve Effect -** The tendency for a fall in the value of the currency to worsen the balance of trade before it improves the position.
- **Joint Stock Bank -** A joint stock bank is one operated by a joint stock or limited company. It is therefore a bank with limited liability. This is in contrast to a private bank which may be owned by a family or individual. All the commercial banks in the UK are joint stock banks.
- **Joint Stock Company -** A firm owned by investors who contribute varying amounts of capital by buying shares. Profits are divided between shareholders in proportion to the number of shares they own.
- **Junk Bond -** A bond (or loan to a company) with a high interest rate to reward the lender for a high risk of default.
- **Just In Time Production -** Just in time is a system of production in which materials, parts and finished products are delivered at the precise time they are needed. This encourages lower stock holdings, shorter lead times, quicker supply chains, better customer contact and relations, greater efficiency and a more profit-focused organisation.
- **Kaldor-Hicks Test -** A change in production or distribution is desirable only if those who gain can compensate those who lose, and still be better off.
- **John Maynard Keynes -** John

Maynard Keynes is probably the best known UK economist. He was born in 1883 and is attributed with having changed the methodology behind economic policy making. He proposed a much more interventionist approach by the government and argued that they should aim to actively manage the level of aggregate demand, for instance, by borrowing money to spend on public works projects like roads, schools and hospitals, to achieve full employment. His best known work was the General Theory of Employment, Interest and Money (1936). For many decades after the Second World War, governments used essentially Keynesian techniques to manage the economy.

- **Keynesian Economics** - the economics of John Maynard Keynes. In modern political parlance, it is the belief that the state can directly stimulate demand in a stagnating economy: for example, by borrowing money to spend on public works projects like roads, schools and hospitals.
- **Kondratiev Cycles** - the discovery of cyclic phenomena of long duration in economic activity is attributed to the Russian economist Nikolai. D Kondratiev (1892 to 1938) who, in the 1920s, described the existence of long waves in the world economy. He based his theory on the observation of trends in the fluctuation of 19th-century economic indicators (mainly prices), and he explained the occurrence of long waves in terms of the durability and production period of and amount invested in, particular types of capital goods. The specific source of the long wave was the tendency of investment in these basic capital goods to occur in clusters. The notion of long waves (or Kondratiev cycles) is a 50-60 year cycle in prices, interest rates and other economic variables. Kondratiev cycles are most readily apparent in monetary data such as prices and interest rates.
- **Labour Force Participation Rate -** The labour force divided by the total working-age population.
- **Labour Force Survey -** A survey of the work force undertaken by the government. The Labour Force Survey has been used since 1997 as the basis for the calculation of the unemployment figures.
- **Labour Force –** People who are employed or are available for work.
- **Labour Market Failure -** When labour markets fail to clear at the going wage rates.
- **Labour Market -** This is made up of firms willing to employ workers and labour seeking employment. The demand for labour by firms is downward sloping with respect to wage (price of labour), while the supply of labour by households is upward sloping with respect to wage. The labour market is in equilibrium where the demand for labour equals the supply of labour.
- **Laffer Curve -** The Laffer curve is named after Professor Art Laffer who suggested that as taxes increased from fairly low levels, tax revenue received by the government would also increase. However, there would come a point as tax rates where people would not regard it as worth working so hard. This lack of incentives would lead to a fall in income and therefore a fall in tax revenue.
- **Laissez Faire -** An economic system where the government intervene as little as possible and leave the private sector to organise most economic activity through markets.
- **Law of Diminishing Marginal Utility -** The more a consumer has of a given commodity the smaller the satisfaction gained from consuming each extra unit.
- **Leakages -** Income not passed on by consumers in the circular flow e.g. savings, taxation or money spent on imports. Leakages are sometimes called withdrawals.
- **Lean Production -** A range of management techniques that aim to make business more efficient in its use of resources. This minimises waste, reduces costs, increases productivity and should expand margins.
- **Least Developed Countries -** The very poorest of the Less Developed Countries.
- **Lender of Last Resort -** The central bank will always lend to the banking sector and thereby ensures sufficient liquidity in the monetary sector to maintain confidence.
- **Less Developed Countries (LDCs) -** Countries who are generally characterised by low levels of GDP and income per head. LDCs usually have a heavy dependence on the primary sector of the economy. In the case of many developed countries this is true with dependence on agriculture and primary products.
- **Leveraging -** Leveraging, or gearing, means using debt to supplement investment. The more you borrow on top of the funds (or equity) you already have, the more highly leveraged you are. Leveraging can maximise both gains and losses. Deleveraging means reducing the amount you are borrowing.
- **Liabilities** - Liabilities are items which are owed (either actually or contingently) to someone. In the case

of the banks, their main liabilities are the deposits of their customers. If a customer comes in asking for money from their account the bank must honour it.

- **Liberalisation -** The opening up of markets to the free market forces of supply and demand.
- **Libertarian -** Those who believe in minimal government interference in the market system, and in the maximum freedom of the individual.
- **LIBOR (The London InterBank Offered Rate)** - this is an interest-rate benchmark gauging how much banks and other finance houses charge each other to borrow money. BBA LIBOR fixing evolved in the early 1980s with the growth of syndicated lending and early developments in the derivatives markets. Since then it has assumed an increasing importance as well over 20% of all international bank lending and more than 30% of all FX transactions take place in London. BBA LIBOR is now used to calculate the interest rates applying to a wide range of contracts. In April 2008, Banks were calling for alternatives to the use of LIBOR due to fears that it may be distorted. The distortion can arise because LIBOR is based on quotes from banks as to the rate of interest they are prepared to lend unsecured funds to other banks but it is difficult to check whether trades are actually conducted at the quoted rates.

Life Cycle Hypothesis - The view that consumption is based on anticipated lifetime income.

- **Limit Pricing -** When a firm sets price just low enough to discourage possible new entrants.
- **Limited Company -** A firm owned by shareholders who enjoy limited liability namely the restriction of a shareholder's loss to the amount of capital invested by them in a company.
- **Liquid Asset Ratio -** The amount of liabilities a retail bank can have from a given volume of liquid assets.
- **Liquid Assets -** Assets which can be turned into cash quickly and easily.
- **Liquidity Preference Curve -** The liquidity preference curve is the demand for money curve. It is thought by Keynesians to be made up of three different types of demand for money - transactions demand, precautionary demand and speculative demand.
- **Liquidity Preference -** The desire to hold money in a variety of forms, e.g. as cash, stocks or bonds.
- **Liquidity Ratio -** The proportion of a commercial bank's assets which can be converted into cash quickly.
- **Liquidity Trap -** When the rate of interest is so low (and the price of bonds is so high) that everyone anticipates a future fall in the price of bonds.
- **Liquidity -** Liquidity refers to the ease with which an asset such as a bank deposit or property can be turned into money.
- **Loan Principal -** The original amount of a loan.
- **Loanable Funds Theory -** The view that the rate of interest is determined by the supply of savings and the demand for funds for investment.
- **Loans to Deposit Ratio -** For financial institutions, the sum of their loans divided by the sum of their deposits. Currently important because using other sources to fund lending is getting more expensive.
- **Local Multiplier -** A rise in an injection such as investment causes a multiple rise in national income. This is the multiplier effect. When an increase in injections occurs in a specific area of a country, there is a multiple rise in local incomes.
- **London Foreign Exchange Market -** The market dealing in the sale and purchase of foreign currencies based in London.
- **Long Run Average Cost Curve -** Shows the minimum unit cost of producing each level of output, allowing the size of plant to vary.
- **Long Run -** Period of time when all factor inputs, including capital, can be changed.
- **Long-Run Phillips Curve -** The long term relationship between unemployment and inflation.
- **Lorenz Curve -** A curve showing the proportion of income earned by a cumulative percentage of the population. The Lorenz curve is a way of illustrating the income distribution of a country.
- **M0 -** A narrow measure of money which consists of notes, coins and retail banks' balances at the Bank of England
- **M4 -** A broad measure of money which consists of notes, coins and all deposits with banks and building societies denominated in sterling.
- **Maastricht Treaty -** The treaty, signed in February 1992, moved significantly towards economic, political and social union and set out the detailed timetable for economic and monetary union (EMU) in the EC. It also set out the convergence criteria for economies who wanted to join in EMU.
- **Macroeconomic Aims -** The aims of macroeconomic policy i.e. high employment, price stability, economic growth and balance of payments

equilibrium.

- **Macroeconomic Policies -** Policies designed to influence the level of employment, the price level, economic growth and the balance of payments.
- **Macroeconomic Stabilisation -** Government policy to stabilise inflation, budget deficits, trade deficits and money supply.
- **Macroeconomics -** The study of the whole economy.
- **Management -** The process of organising resources.
- **Marginal Cost Curve -** A curve showing the addition to total cost resulting from producing one more unit.
- **Marginal Cost Pricing -** Setting price equal to marginal cost.
- **Marginal Costs -** The amount spent on producing one extra unit. The marginal cost is the increase in total cost when one more unit is produced.
- **Marginal Efficiency of Capital -** The expected rate of return on investment.
- **Marginal External Benefit -** The change in positive externalities resulting from the consumption of one more unit.
- **Marginal External Cost -** The change in negative externalities resulting from the production of one more unit.
- **Marginal Private Benefit -** The increase in private benefit resulting from the consumption of one more unit or the production of one more unit.
- **Marginal Private Cost -** The increase to a firm from the consumption or production of one more unit.
- **Marginal Product of Labour -** The addition to output made by each extra worker.
- **Marginal Product -** The addition to total product following the employment of an extra unit of a variable factor, e.g. labour.
- **Marginal Propensity to Consume -** The proportion of each extra pound of disposable income spent by households. For example, if a person earns 1 more and consumes 60p of it, then the MPC is 0.6.
- **Marginal Propensity to Import -** The proportion of each extra pound of income spent on imports. An MPI of 0.4 would mean that 4 pounds more was spent on imports when 10 pounds extra was earned.
- **Marginal Propensity to Save -** The proportion of each extra pound of disposable income not spent by households.
- **Marginal Rate of Tax -** The proportion of each extra pound of income taken by the government. The marginal rate of tax is therefore the rate of tax paid on the next pound earned. In the case of income tax this will increase as a person moves from one band to the next.
- **Marginal Revenue Product (MRP) -** The addition to total revenue following the employment of an extra unit of a variable factor, e.g. labour.
- **Marginal Revenue -** The income received from the sale of one extra unit.
- **Marginal Social Cost -** The cost incurred by both the firm and society in producing each extra unit of a good.
- **Marginal Utility -** The satisfaction gained from the consumption of one extra unit of a good.
- **Market Concentration -** The extent to which the sale of a product is dominated by the largest firms in the industry.
- **Market Economies -** A system where markets allocate resources through the price mechanism; and income depends upon the value of resources owned by an individual.
- **Market Economy -** A system where resources are owned by households, markets allocate resources through the price mechanism; and income depends upon the value of resources owned by an individual.
- **Market Failure -** Market failure occurs when the workings of the price mechanism are imperfect and result in an inefficient or grossly unfair allocation of resources from the perspective of society. Examples include the education and defence markets.
- **Market for Loanable Funds -** Where companies go to borrow the money for investment, and where consumers go to put their savings away.
- **Market Prices -** Market or purchaser's prices are the prices actually paid by the purchaser for goods and services, including transport costs, trade margins and taxes.

  GDP at market prices = GDP at basic prices+ transport prices paid separately+ non deductible taxes on expenditure- subsidies received.
- **Mark-To-Market -** Recording the value of an asset on a daily basis according to current market prices. So for a futures contract, what it would be worth if realised today rather than at the specified future date. Also marked-to-market.
- **Marshall Lerner Condition –** This states that a devaluation (currency becomes weaker) will improve the current account balance (exports minus imports) if the combined price

elasticities of demand for exports and imports are greater than 1.

- **Measurable Economic Welfare -** Adjusts GDP by adding the value of such items as leisure time, D.I.Y. and unpaid housework and deducting expenditure on items such as defence, police and road maintenance and negative externalities.
- **Measure of Value -** Money is used to compare the value of goods, services and factor rewards.
- **Medium of Exchange -** Anything which is generally accepted as a means of paying a debt.
- **Medium-Term Projections or Scenarios -** Looking out five to six years, and published as part of the OECD's projection exercise. These scenarios basically indicate the requirements necessary to bring economies back to overall balance over the medium term - in terms of closing the output and employment gaps. Moreover, they typically act as baseline scenarios for macroeconomic simulations of the effects of various alternative assumptions on economic policy or other forces affecting the projections.
- **Merchant Banks -** Banks which provide services mainly to companies including issuing new shares.
- **Merit Goods -** A product, such as education, which consumers may undervalue but which the government believes is 'good' for consumers. Merit goods would be under-provided in a pure free-market economy.
- **Microeconomic Policies -** Policies designed to improve the efficiency of individual markets.
- **Microeconomics -** The behaviour of an individual consumer, firm and industry.
- **Milton Friedman -** The best known of all Monetarists. He is a well-known economist and one He is a great believer in the power of the free market and much of his work has been based around this. Milton Friedman's best known work is on the Quantity Theory of Money. He extended this classical piece of analysis, tested it and put it into a more modern context. However, he also did quite a bit of work on the theory of distribution and argued for a new way of looking at the way people decide on their consumption - the permanent-income hypothesis.
- **Minimum Lending Rate -** The rate, announced in advance, at which the Bank of England used to lend to the discount houses. The interest rate is now set by the Monetary Policy Committee of the Bank of England each month.
- **Mixed Economy -** A society where resources are owned by both private individuals and the government.
- **Mobility of Labour -** The extent to which labour can move between jobs and regions.
- **Modigliani & Millers (MM) Capital Structure Theories -** (i) MM-no tax, which proves that no optimal capital structure exists, and that the WACC is invariant to debt / equity ratio; or (ii) MM-with tax which suggests that the tax shield should be exploited up to the point of almost 100 per cent debt financing.
- **Monetarists -** A group of economists who believe that changes in the money supply are the most effective instrument of government economic policy, and the main determinant of the price level.
- **Monetary Aggregates -** Measures of the stock of money in circulation outside the banking system. Because of the lack of clarity concerning the concept of money there are various statistical definitions of the money stock. As a general rule, narrow definitions include only the currency in circulation plus sight deposits held by domestic non-banks, while broad definitions additionally include time deposits as well as savings deposits at short notice held by domestic non-banks. Not all countries publish the same types of aggregates, and, even when aggregates have the same name their asset composition often differs significantly. In the euro area, monetary aggregates definitions are based on harmonised definitions of the issuing and holding sectors and the financial sectors' liabilities. When the monetary policy strategy includes elements of monetary aggregate targeting, the choice of the definition of the targeted aggregate is guided mainly by two considerations. The aggregate should be sufficiently sensitive to interest rate changes for the central bank to be able to control it and display a stable relationship over time to the movement of the overall price level.
- **Monetary Base Control -** Involves the Bank of England regulating base money. The monetary base of the economy is usually taken as the stock of cash that an economy has i.e. the level of notes and coins. The closest measure of the money supply that we have to this in the UK is M0. Some monetarists argued that the level of the money supply in the economy could be controlled by strict control of the monetary base. By tightly limiting the level of notes and coins available, financial institutions would be unable to expand their assets too quickly. They would have to be sure they had enough cash to operate. This process is known

as monetary base control.

- **Monetary Policy Committee (MPC) -** The Monetary Policy Committee is a committee of the Bank of England chaired by the Governor that meets monthly to set the level of interest rates in the economy. They set interest rates according to the targets they have been set for inflation.
- **Monetary Policy Instruments -** Tools of monetary policy including interest rate changes and open market operations.
- **Monetary Policy -** The use by government of changes in the supply of money and interest rates to achieve desired economic policy objectives. They aim therefore to influence the level of economic activity.
- **Monetary Transmission Mechanism -** The transmission mechanism of monetary policy is the way in which interest rate changes affect economic activity and inflation. The main impact is through the level of aggregate demand. Higher interest rates limit people's ability to spend and so reduce aggregate demand. However, there are a variety of other effects as well through expectations, asset prices and the exchange rate.
- **Money Income -** Income measured in nominal terms i.e. not adjusted for inflation.
- **Money Market -** A market where debt securities, issued with maturities of one year or less, are traded.
- **Money Measures -** Measures of the amount of money in circulation in the economy. The two main measures are M0 and M4.
- **Money National Income -** The value of the current year's output at current prices.
- **Money Supply -** The amount of money which is in an economy at a given point in time. There is no one agreed definition of the money supply largely because money takes many different forms, not all of which are agreed to be money by all economists.
- **Money -** Money is anything that fulfils the functions required for exchanging goods and services. Money should act as a unit of account, a medium of exchange, a standard for deferred payment and a store of value if it is to be most effective.
- **Monoline –** a company specialising in a single type of financial business, such as credit cards, home mortgages or a sole class of insurance and which may use direct marketing practices and statistical models to target specific customers.
- **Monoline Insurance –** These Monolines insure against the risk that a bond will default. Companies and public institutions issue bonds to raise money. If they pay a fee to a monoline to insure their debt that in turn helps to raise the credit rating of the bond which in turn means the institutions can raise the money more cheaply.
- **Monopoly -** In theory, an industry where one firm produces the entire output of a market. In practice, in the UK any one firm that has 25% of a market is considered to have monopoly control.
- **Mortgage-Backed Securities -** Securities made up of mortgage debt or a collection of mortgages. Banks repackage debt from a number of mortgages which can be traded. Selling mortgages off frees up funds to lend to more homeowners.
- **Moving Average Smoothing -** A form of average which has been adjusted to allow for seasonal or cyclical components of a time series so as to make long term trends clearer.
- **Multi-Fibre Agreement -** A set of bilateral quotas imposed by industrialised countries on the exports of textiles from less developed countries.
- **Multilateral Aid -** Aid channelled through international organisations.
- **Multinational -** A large company operating in a number of countries and owning facilities outside the country of its origin.
- **Multiplier Effect -** The overall effect of an increase in investment on national income.
- **Mutual Fund -** A regulated investment company that pools money and invests in various assets.
- **MV = PT -** The Fisher Equation of Exchange.
- **NAFTA -** North American Free Trade Agreement between United States, Canada and Mexico.
- **NAIRU -** Non-accelerating inflation rate of unemployment.
- **Naked Short Selling -** A version of short selling, illegal or restricted in some jurisdictions, where the trader does not first establish that he is able to borrow the relevant asset.
- **Narrow Money -** The main measure of narrow money in the UK is M0. M0 includes notes and coins and banks balances at the bank of England.
- **National Accounts -** A coherent, consistent and integrated set of macroeconomic accounts, balance sheets and tables based on a set of internationally agreed concepts, definitions, classifications and accounting rules.

- **National Debt -** The total amount of borrowing accumulated by the government that is still outstanding. Each year the National Debt will rise by the amount of the PSNCR, and fall by the amount of debt that is paid off.
- **National Expenditure -** The total level of expenditure in an economy. It will also be equivalent to the total level of output and the total level of income in the economy.
- **National Income Accounts -** The system used to measure the value of national income, output and expenditure.
- **National Income -** The value of goods and services created by a country in one year.
- **Nationalisation -** The act of bringing an industry or assets like land and property under state control.
- **Natural Rate of Population Growth -** The growth in population due to changes in the birth and death rates.
- **Natural Rate of Unemployment -** The level of unemployment that is associated with a constant rate of inflation.
- **NAWRU -** Non-accelerating wage rate of unemployment.
- **NedCo -** A committee of the non-executive directors of the Bank of England responsible for reviewing the Bank's performance in relation to its objectives and strategy.
- **Negative Equity -** When the value of a house is less than the home owner's mortgage on it.
- **Negative Externality -** An impact or cost on third parties resulting from the activity of others.
- **Neo-Classical Theory -** The view that markets operate efficiently and that the way to increase output and employment is to raise aggregate supply.
- **Net Domestic Product -** Net National Product minus property income from abroad.
- **Net Investment -** Gross investment less depreciation.
- **Net Lending -** The excess of net acquisitions of financial assets by transactors over their net incurrence of liabilities.
- **Net National Product -** The technical term for national income, it is GNP minus capital consumption.
- **Net Present Value (NPV)** - the sum of all the annual negative and positive present values of future cash flows from operations. The present values are calculated by discounting the cash flows at the cost of capital. The NPV at the cost of capital is equivalent to the shareholder value created by the project.
- **Net Property Income from Abroad -** The difference between incomes earned and incomes paid abroad.
- **Net Social Benefit -** The positive difference between social benefit and social cost.
- **Net Transactions -** The difference between transactions in assets and transactions in liabilities.
- **Nominal National Income -** The value of this year's output at current prices.
- **Nominal Rate of Interest -** The annual return form lending money expressed as a percentage, without having taken account of the rate of inflation.
- **Non Governmental Organisations (NGOS) -** Privately owned organisations involved in providing financial and technical assistance to less developed countries.
- **Non-Marketed Output -** Economic activity which is not recorded in official national income figures.
- **Non-Operational Balances -** Accounts kept by the banking sector at the Bank of England which are not drawn on.
- **Non-Profit Institutions Serving Households (NPISH) -** This category includes bodies such as Charities, Universities, Churches, Trade Unions or Members Clubs. This category is normally included in the Household and NPISH sector within National Accounts.
- **Non-Renewable Resources -** Resources which are finite i.e. not replaced.
- **Non-Tariff Barriers -** All barriers to trade that are not tariffs. Examples of these include countervailing and anti-dumping duties, "voluntary" export restraints, subsidies which sustain in operation loss making enterprises, technical barriers to trade, and obstacles to the establishment and provision of services.
- **Non-Wage Benefits -** Rewards for labour that are received in a form other than money e.g. meal vouchers, free uniform, free travel to work.
- **Normal Profits -** The minimum the amount a firm must receive to carry on production.
- **Normative Economics -** Statements of opinion which cannot be proved or disproved, and suggests what should be done to solve economic problems.
- **Not For Profit -** Any organisation that does not seek to make a surplus. Usually, these are charities.
- **Occupational Immobility -** Where

resources do not freely move from one purpose to another.

- **Occupational Mobility -** The extent to which factors of production can move between different occupations.
- **Offer Curve of Labour -** The number of hours labour is prepared to work at different levels of income.
- **Official Development Assistance -** Disbursements of loans and grants at concessionary rates by governments.
- **Official Exchange Rate -** The rate at which the Central Bank will exchange the local currency for foreign currency.
- **Oil Prices -** Unless otherwise noted, oil prices refer to the price of Brent crude as quoted on the London Petroleum Exchange.
- **Oligopoly -** A market dominated by a very few sellers who account for a large proportion of output.
- **Open Economy -** An economy which engages in international trade.
- **Open Market Operations -** Where the Bank of England sells short term government securities and bills, thereby reducing retail banks' liquid assets and raising interest rates. If the government sells large amounts of gilt-edged securities, this will mean a transfer of funds from the private sector to the government. This will happen as people buy securities and so have to write cheques or transfer money to the Bank of England who sold them. This means that the banks have less in the way of liquid funds available, and so they are unable to expand their loans as quickly. Selling gilt-edged securities is therefore considered to be a contractionary monetary policy.
- **Operating Surplus -** Gross output at producers' values less the sum of intermediate consumption, compensation of employees, consumption of fixed capital and indirect taxes reduced by subsidies.
- **Operational Balances -** Accounts which the banking sector hold at the Bank of England to settle debts and to draw on.
- **Opportunity Cost -** The decision to produce or consume a product involves giving up another product. The real cost of an action is the next best alternative forgone.
- **Optimum Allocation -** Occurs when it is not possible to redistribute goods to increase the welfare of any one consumer without reducing the welfare of some other consumer.
- **Optimum Output -** When average cost is minimised.
- **Optimum Population -** When productivity (output per person) is highest.
- **Option -** A contract (often referred to as "call/put" option) for the right to buy/sell a given amount of a specific asset at a fixed price on the expiry of the contract.
- **Organisation for Economic Cooperation and Development (OECD)** - The aim of the OECD is to build strong economies in its member countries, improve efficiency, hone market systems, expand free trade and contribute to development in industrialised as well as developing countries. The OECD groups 30 member countries share a commitment to democratic government and the market economy. With active relationships with some 70 other countries, NGOs and civil society, it has a global reach. Best known for its publications and its statistics, its work covers economic and social issues from macroeconomics, to trade, education, development and science and innovation.
- **Output Gap -** The output gap is the difference between what the economy is actually producing and what it could potentially produce. A positive output gap means that we are producing less than we potentially could, while a negative one means that we are stretching our resources to the limit and producing more than our potential.
- **Output -** The goods and services produced as a result of economic activity.
- **Outward Oriented Development -** Government policy that attempts to achieve development by encouraging free trade and the unrestricted movement of labour and capital.
- **Overmanning -** The employment of more labour than is needed to produce a given output.
- **Overpopulation -** When a reduction in population size would increase output per head i.e. it is above the optimum population.
- **Overproduction -** When production is above the socially optimum level.
- **Overseas Investment -** The purchase of overseas financial and physical assets.
- **Paper Money -** Bank notes. Sometimes also used to describe notes and coins.
- **Paradox of Thrift -** A situation whereby an increase in saving results in a fall in national income.
- **Parallel Economy -** The production that takes place outside of the declared and formal circular flow of income.
- **Pareto Optimal -** A situation in which economic welfare is maximised. In other words when no one can be made better off without someone else being

made worse off, following a reorganisation of production or distribution.

- **Paris Club -** A group formed by certain industrialised countries that are owed substantial amounts of debt by less developed countries.
- **Participation Rate -** The percentage of the population of working age in the labour force.
- **Partnership -** A firm owned by between 2 or more people who share the profits and usually have unlimited liability for the debts of the firm.
- **Pearson's Product Moment Correlation Coefficient -** A measure of the linear association between two variables that have been measured on interval or ratio scales, such as the relationship between height in centimetres and weight in grams.
- **Pensioners' Retail Price Index (PRPI) -** A statistical measurement of a typical basket of goods typically purchased by people of pensionable age.
- **Percentile -** Percentiles are values that divide a sample of data into one hundred groups containing (as far as possible) equal numbers of observations. For example, 30% of the data values lie below the 30th percentile.
- **Perfectly Competitive Markets -** A market made up of a large number of firms producing identical products with total freedom of entry to and exit from the market e.g. wheat.
- **Perfectly Contestable Market -** A market where the costs of entry and exit into and from an industry are zero.
- **Periphery Regions -** Geographical areas on the outskirts of key economic activity.
- **Permanent Income Hypothesis -** The permanent income hypothesis was developed by Milton Friedman and it says that people will look at long-run (permanent) income when deciding how much to consume. Where actual income is unusually high people realise this isn't permanent and they will save correspondingly. On the other hand where income is lower they may still consume at a higher level using up savings. In other words Milton Friedman argued that spending is based on average lifetime income.
- **Perverse Demand Curve -** A perverse demand curve is one which slopes upwards from left to right showing that an increase in price leads to an increase in demand. This may happen where goods are strongly affected by price expectations or in the case of Giffen goods.
- **Phillips Curve -** A relationship between unemployment and inflation discovered by Professor A.W.Phillips. He found that there was a trade-off between unemployment and inflation, so that any attempt by governments to reduce unemployment was likely to lead to increased inflation.
- **Physical Quality of Life Index -** A composite indicator of development composed from life expectancy, literacy rate, and infant mortality.
- **Piotroski (or F) Score -** a method of evaluating stocks devised by Joseph Piotroski, an Accounting Professor at the University of Chicago. He reasoned that because value stocks are troubled companies by definition, many are financially distressed and won't have the financial resources to recover. Pondering on whether he could improve the performance of a value portfolio by throwing out the financially weakest stocks. Piotroski devised a simple nine-criteria stock-scoring system for evaluating a stock's financial strength that could be determined using data solely from financial statements. One point was awarded for each test that a stock passed. Piotroski classed any stocks that scored eight or nine points as being the strongest stocks. His findings were that these strong stocks as a group outperformed a portfolio of all value stocks by 7.5% annually over a 20-year test period. Piotroski also found that weak stocks, scoring two points or fewer, were five times more likely to either go bankrupt or delist due to financial problems.
- **Planned Economies -** Economies in which the state decides what goods are produced, the methods of production, and who gets the goods.
- **Planned Injections -** Additions to income which include exports, government spending and investment.
- **Planned Withdrawals -** Income not passed on in the circular flow of income i.e. saving, taxation and imports.
- **Ponzi Scheme** – This is an investment scam that appears to pay high returns within a short period of time and at little risk. However, it does so by paying the supposed returns out of the victims' own capital. It’s the name given to fraudulent "make money fast" schemes promoted through the Internet and elsewhere. It only generates returns only by recruiting new investors and the money collected from them is used to pay the return. The scam is named after Carlo (Charles Ponzi), a clerk in Boston, USA, who first used the scheme in 1919.
- **Positive Economics -** Statements of fact, which can be proved or disproved, and which concern how an economy works.

- **Positive Externalities -** Impacts on 'outsiders' that are advantageous to them and for which they do not have to pay.
- **Potential GDP -** Defined in the Economic Outlook as the level of output that an economy can produce at a constant inflation rate. Although an economy can temporarily produce more than its potential level of output, that comes at the cost of rising inflation. Potential output depends on the capital stock, the potential labour force (which depends on demographic factors and on participation rates), the NAIRU, and the level of labour efficiency.
- **Potential Output -** The output that could be achieved if all resources were to be fully deployed. Potential output tends to grow each year as technology and productivity improve each year.
- **Poverty Trap -** A situation in which a rise in income results in the recipient being worse off once tax has been paid and benefits withdrawn.
- **Pre-Budget (PBR) –** The Pre-Budget Report: one of the two economic forecasts that HM Treasury is required to deliver to Parliament each year, the other being the annual Budget (The Budget).
- **Precautionary Motives -** The desire to hold money to meet unexpected expenses and take advantage of bargains: 'just in case' money.
- **Preference Shares -** A class of shares that usually do not offer voting rights, but do offer a superior type of dividend, paid ahead of dividends to ordinary shareholders. Preference shareholders often also have superior status in the event of a winding up.
- **Present Value -** Future value expressed in present terms by means of discounting.
- **Price Deflator -** An index used to eliminate the effect of inflation.
- **Price Discrimination -** When the same product is sold in different markets for different prices. Also known as Price Differentiation.
- **Price Earnings Ratio -** The price of a company's stock divided by its previous year's earnings.
- **Price Effect -** The effect of a price change on demand for a product. It is made up of the income effect and the substitution effect.
- **Price Elasticity of Demand -** Measures the responsiveness of demand to a given change in price. It is an important piece of information to a firm as it helps them predict how much the demand for their product will change if they change price. It is calculated by dividing the % change in the demand by the % change in the price. If the figure is greater than one then the product is described as elastic or demand is sensitive to price. This implies that the change in the demand will be proportionately larger than the change in price. If the price elasticity of demand is less than one, then an increase in price will cause the total revenue to increase.
- **Price Elasticity of Supply -** Measures the responsiveness of supply to a given change in price. It is calculated by dividing the % change in the quantity supplied by the % change in the price. If the figure is greater than one then the product is described as elastic or supply is sensitive to changes in price. This implies that the change in the quantity supplied by firms will be proportionately larger than the change in price. However, if the value is less than one then the good has an inelastic supply curve. Therefore, a change in price will have very little impact on the quantity supplied by the firm.
- **Price Floor -** A minimum limit for a price below which it is prevented from moving.
- **Price Index -** See Retail Price Index.
- **Price Instability -** Fluctuations in price arising from unstable demand and supply conditions.
- **Price Makers -** Firms whose output influences price.
- **Price Mechanism -** Prices act as a signal to firms and consumers to adjust their economic behaviour. For example a rise in price encourages producers to switch into making that good but encourages consumers to use an alternative substitute product. Price signals will only work effectively if there is low inflation. If inflation is high and unpredictable, then relative price changes may get muddled with general price increases.
- **Price Stability -** One of the 3 core purposes of the Bank of England, price stability is where prices change by a small and consistent amount.
- **Price Taker -** Firms whose output does not influence price. Particularly apparent in perfectly competitive markets.
- **Primary Banking System -** Includes financial institutions whose main function is to provide a money transmission service.
- **Primary Data -** Information that is original and has been gathered first hand.
- **Primary Market -** A market where new issues (initial public offerings) of stocks and bonds are sold, and where the proceeds go to the issuer.
- **Primary Sector -** That part of the economy concerned with agriculture

and the extraction of raw materials.

- **Prime Rate -** A term used primarily in North America to describe the standard lending rate of banks to most customers.
- **Principle of Multiples -** The ability of large firms to combine machines in proportions which ensure they operate at their optimum level.
- **Private Benefits -** The advantages of an economic activity to an individual.
- **Private Costs -** The disadvantages of an economic activity to an individual.
- **Private Finance Initiative (PFI) -** Private sector financing and management of public services (e.g. school buildings) in order to transfer associated risks to the private sector and achieve better value for money.
- **Private Good -** A private good is one which is both rival and excludable. One person's consumption will mean that the good is not available for another person to consume it.
- **Private Limited Company -** A Private Limited Company is an incorporated business which is owned by a few shareholders. Its shares cannot be made available for sale to the general public. Its shareholders enjoy limited liability.
- **Private Sector -** That part of the economy in the control of individuals and companies.
- **Privatisation -** Sale of government-owned shared in private sector companies
- **Probability -** A probability provides a quantitative description of the likely occurrence of a particular event. Probability is conventionally expressed on a scale from 0 to 1; a rare event has a probability close to 0, a very common event has a probability close to 1.
- **Probability Distribution -** The probability distribution of a discrete random variable is a list of probabilities associated with each of its possible values. It is also sometimes called the probability function or the probability mass function.
- **Problem Children -** A product that has a low market share within an expanding market. Also known as a wild card. See Boston Matrix.
- **Producer Goods -** Capital items such as machinery.
- **Producer Price Index (PPI) -** A statistical measurement of a typical set of raw materials and other inputs purchased by firms.
- **Producer Support Estimates (PSE) -** An indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level, arising from policy measures, regardless of their nature, objectives or impacts on farm production or income.
- **Producer Surpluses -** The difference between the minimum price a producer would accept to supply a given quantity of a good and the price actually received.
- **Product Curves -** Curves showing total, average and marginal product.
- **Product Markets -** The markets for factors of production, land, labour and capital.
- **Production Possibility Boundary -** The combination of two goods a country can make in a given time period with resource fully employed.
- **Production Quota -** A limit on the amount of a good produced.
- **Production Weighted Tariff Rate -** In concept similar to producer support estimates. A measure of the value of transfers from domestic consumers to domestic producers. The measure does not capture the efficiency costs, and thus the loss in economic welfare attributable to such measures.
- **Production -** The output of goods and services.
- **Productive Capacity -** The amount that a firm or plant could produce if all the resources available to it were to be employed 'flat out'.
- **Productive Efficiency -** When a firm produces at the lowest unit cost.
- **Productivity -** Total output divided by the number of factors of production.
- **Profit Margin -** The profit as a percentage of turnover (or sales). It shows how profitable the firm is. The higher the margin the better for the firm.
- **Profit Warning -** When a company issues a statement indicating that its profits will not be as high as it had expected.
- **Profits -** The reward for bearing uninsurable risks associated with production.
- **Progressive Tax -** A progressive tax is a tax that takes an increasing proportion of income as income rises. Income tax is an example of a progressive tax, as the rate increases as a person earns more.
- **Protectionism -** The practice of taking steps to protect what one sees as one's own interests. Most commonly used to describe steps taken by countries to protect their domestic industries from foreign competition.
- **Prudential Ratios -** Liquidity ratios

kept by banks which are considered to be safe.

- **Public Corporations -** Corporations wholly, or mainly, owned and/or controlled by the public authorities. All public financial institutions are treated as corporations.
- **Public Enterprises -** Government enterprises and public corporations. In either case organisations which are entirely, or mainly, owned and/or controlled by the public authorities consisting of establishments which by virtue of their kind of activities, technology and mode of operation are classed as industries.
- **Public Expenditure -** Spending by the government.
- **Public Goods -** Items which can be jointly consumed by many consumers simultaneously without any loss in quantity or quality of provision e.g. a lighthouse. Public goods are therefore goods that would not be provided in a pure free-market system. This is because they display two particular characteristics:
  - Non-rivalry - consumption by one person does not reduce the amount available for others.
  - Non-excludability - once the good is provided it is impossible to stop people consuming it even if they haven't paid. An example of this is defence.
- **Public Limited Company (PLC) -** A company constituted as such (usually with many shareholders) with a separate legal existence from its shareholders who enjoy limited liability.
- **Public Sector Debt Repayment (PSDR) -** The amount by which in any one year government income from taxation, receipts from privatisation, etc exceed government expenditure. A PSDR is effectively a negative PSBR. The PSBR and PSDR are now known as the Public Sector Net Cash Requirement which is either a positive or negative amount.
- **Public Sector Net Cash Requirement (PSNCR) -** This used to be called the Public Sector Borrowing Requirement (PSBR) and is the amount of money the government need to borrow to meet their spending plans. In other words it the amount by which their spending exceeds their tax revenue.
- **Public Sector -** General government sector plus all public corporations, including the central bank.
- **Purchasing Power Parity (PPP) -** International comparisons of GDP depend on two conditions being met. The first is that the basis of calculating GDP is consistent for the countries under comparison. The second is that the unit in which GDP is expressed (the numeraire, the basic standard by which values are measured, such as gold in a monetary system) is comparable. PPPs are the rates of currency conversion which equalise the purchasing power of different currencies. This means that a given sum of money, when converted into different currencies at the PPP rates, will buy the same basket of goods and services in all countries. In other words, PPPs are the rates of currency conversion which eliminate the differences in price levels between countries. Thus, when expenditures on GDP for different countries are converted into a common currency by means of PPPs, they are expressed, in effect, at the same set of international prices so that comparisons between countries reflect only differences in the volume of goods and services purchased.
- **Purchasing Power Parity Exchange Rate -** The PPP rate is the exchange rate at which the money you exchange would buy exactly the same basket of goods in both countries. For example, say a certain basket of goods costs 25, and the same basket costs $50. The PPP rate would be 1 = $2. The PPP rate will often differ from the actual rate.
- **Pure Economic Rent -** The reward to any factor that is in completely inelastic supply.
- **Q -** Abbreviation for quarter (3 months).
- **Qualitative Controls -** Controls that aim to limit the nature or variety of a variable rather than the quantity supplied, e.g. a qualitative control would not limit the amount of lending available just the type of loans.
- **Quantitative Controls -** Controls that limit the quantity of something, e.g. the Supplementary Special Deposit Scheme which limited the amount that banks could lend.
- **Quantitative Easing -** Quantitative easing was first used as a tool of monetary policy by the Bank of Japan to fight domestic deflation in the early 2000s. It's a term used when a central bank creates money out of 'thin air' to inject into the banking system. The aim is to increase the amount of deposits in private banks so that, by way of deposit multiplication, they can increase the money supply by increasing debt (lending). *'Quantitative'* refers to the money supply; *'easing'* refers to reducing the pressure on banks. A central bank can do this by buying government bonds (treasury securities in the US) in the open market, or by lending money to deposit-taking institutions, or by buying assets from banks in exchange for currency, or any combination of these

actions. These have the effects of reducing interest yields on government bonds, and reducing inter-bank overnight interest rates, and thereby encourage banks to loan money to higher interest-paying bodies. In layman's terms, the central bank creates more money (a liability for the central bank) and uses this money to buy securities in the open market (an asset).

- **Quantity Theory of Money -** The theory (derived from the Fisher Equation of Exchange) that an increase in the money supply would lead to inflation.
- **Quarterly Growth Rate -** Growth of a variable over the previous quarter, expressed at an annual rate. Quarterly growth rates can be calculated as the percentage changes between two consecutive quarters. It is often convenient, however, to convert such measures of quarterly growth into a form which is more readily comparable with annual growth figures, i.e. to express them at annual rates. The quarterly growth rate is compounded over four quarters to provide the annual rate of growth which would result from the continuation of the quarterly rate of growth over a one-year period.
- **Quasi-Rent -** Short-term economic rent arising from a temporary inelasticity of supply.
- **Quotas -** Limits on the amount of a good produced, imported, exported or offered for sale.
- **Rappaport's Value Drivers** - Pioneered by Alfred Rappaport, the shareholder value approach is by definition forward looking, cash based, long term, and risk adjusted. Rappaport says there are seven key factors which determine value. They are: (1) Sales growth rate; (2) Operating profit margin; (3) Tax rate; (4) Incremental fixed capital investment; (5) Incremental working capital investment; (6) The planning horizon; and (7) The required rate of return.
- **Ratchet Effect -** Any situation in which the response in one direction is markedly different to the response in the opposite direction, e.g. trade unions are quick to push for higher wages when economic activity picks up but are very slow to agree to lower wages when economic activity falls.
- **Rate of Interest -** See Interest Rates.
- **Rate of Return -** The profit a firm earns expressed as a percentage of the assets a firm owes.
- **Rating -** Bonds are rated according to their safety from an investment standpoint - based on the ability of the company or government that has issued it to repay. Ratings range from AAA, the safest, down to D, a company that has already defaulted.
- **Real Terms -** When the effects of inflation have been taken into account. If a variable is given in real terms, this means that the effect of inflation has been removed. ‘Real’ may be used in relation to income, interest, assets etc.
- **Real Wage -** The value of an income expressed in terms of its purchasing power i.e. what it is possible to buy with a given money income.
- **Realised Investment -** Actual investment, it includes both capital goods and changes in stocks.
- **Reallocation of Resources -** When land labour and capital are put to a different use.
- **Recapitalisation -** The injection of fresh money into a firm, thus reducing the debts of a company. For example, when a government intervenes to recapitalise a bank, it might give cash in exchange for some form of guarantee, such as a stake in the company. Taxpayers can then benefit if the bank recovers.
- **Recession -** A period of negative economic growth at the trough of the trade cycle. A recession is usually defined as two consecutive quarters of negative economic growth. In the United States, a larger number of factors are taken into account, like job creation and manufacturing activity. However, this means that a US recession can usually only be defined when it is already over.
- **Rediscount Credit -** The credit which a central bank grants financial institutions against the purchase of bills of exchange.
- **Redistributive Effects -** The results of taking money from one group of people and giving it to another group, usually through taxation.
- **Reflate -** To reflate the economy means to try to boost the level of economic activity. This generally means using reflationary policies. This will shift aggregate demand to the right and boost the level of economic activity.
- **Reflationary Policies -** Any fiscal or monetary policies that aim to boost the level of economic activity.
- **Regression Equation -** A regression equation allows us to express the relationship between two (or more) variables algebraically. It indicates the nature of the relationship between two (or more) variables. In particular, it indicates the extent to which you can predict some variables by knowing others, or the extent to which some are associated with others.

- **Regressive Taxes -** Taxes which take a higher proportion of income from the poor than the rich. An example of a regressive tax is the television licence. It is exactly the same amount for everyone, which makes it a much smaller proportion of a large income than a small one.
- **Relative Income Hypothesis -** The theory put forward by Duesenberry that people's consumption is influenced by the spending pattern of others.
- **Rent of Ability -** The payment that someone receives, over and above the payment that they might well be willing to work for, resulting from the uniqueness or comparative rarity of their particular talent, skill, expertise e.g. the wages paid to prolific goal scorers.
- **Replacement Ratio -** The ratio between income in and out of work.
- **Repo -** A sale and repurchase agreement used to relieve shortages of liquidity in the market. A bank may sell a gilt-edged security (or other asset) back to the Bank of England in exchange for cash. They agree to buy the gilt back again later. It is a way for them to get hold of cash in the short-term to ensure they can meet their day to day commitments. The Bank of England use it as a way to maintain the level of interest rates set by the Monetary Policy Committee.
- **Repurchase (Repo) Rate -** The interest rate paid at the time of the repurchase of the securities in a repurchase agreement.
- **Reserve Assets -** Liquid assets held by commercial banks capital held back from investment in order to meet probable or possible demands.
- **Reserve Currency -** A currency held by central banks to intervene in foreign exchange markets and to settle international debts.
- **Reserve Requirements -** The minimum reserves required for depository institutions. They are set by the central bank within limits specified by laws for depository institutions. A change in the minimum reserve ratio affects the amount of its deposit base a financial institution can lend out. Reserve requirements are an instrument of monetary policy.
- **Residual Error -** The value used in national income accounting to balance up the difference between the income and expenditure methods.
- **Resources -** Inputs used in the production of goods and services.
- **Retail Co-Operative -** A retailing business run by its members on an equal vote basis.
- **Retail Deposit -** A deposit of money with a "retail" or high-street financial institution. Retail banks tend to deal with individuals and small businesses.
- **Retail Price Index (RPI)** – the main domestic measure of inflation in the UK. It measures the average change from month to month in the prices of goods and services purchased by most households in the United Kingdom. It is weighted to reflect the fact that some price changes are more important than others. The weights are based on the Family Expenditure Survey which surveys a wide range of families to see how they spend their money. Like all index numbers it has a base year, and all changes are expressed as percentage changes around that base.
- **Retail Price Index X (RPIX)** – RPIX is an adjusted measure of inflation. It is often alternatively called the "underlying rate of inflation". It is the basic Retail Price Index adjusted for the effects of changes in interest rates. As interest rates are increased (to counter inflation), this will tend to lead to an increase in mortgage rates. Because mortgage costs are included in the RPI as a measure of the costs of housing, this will lead to an increase in the RPI. So increasing interest rates to reduce inflation leads to an increase in inflation. RPIX removes this effect to give a better picture of underlying inflation.
- **Retail Price Index Y (RPIY)** – RPIY is an adjusted measure of inflation. It is the basic Retail Price Index, adjusted for the effects of changes in interest rates and indirect taxes. Both of these changes can distort the Retail Price Index, and so RPIY can provide a useful measure of the underlying trends.
- **Retained Earnings -** Money not paid out as dividend and held awaiting investment in the company.
- **Returns to Scale -** The relationship between changes in the quantity of factors of production and the resulting change in output.
- **Revaluation of Sterling -** Occurs when the UK government raises the value of the £ from one fixed rate to another.
- **Revenue Neutral Policies -** If the government decide to reduce the level of taxation, they may also want to reduce the level of government expenditure by an equivalent amount. This would mean that the tax cut has no effect on the PSNCR. It is therefore termed a revenue-neutral policy.
- **Revenue -** The money receivable from the sale of output.
- **Rights Issue –** Usually, when a public company issues new shares to raise cash. The company might do this for a number or reasons - because it is

running short of cash, or because it wants to make an expensive investment. By putting more shares on the market, a company dilutes the value of its existing shares.

- **Risk-Bearing Economies of Scale -** The ability of large firms to spread the costs of uncertainty of production over a large level of output and thereby reduce unit costs.
- **Risk-Free Interest Rate -** Return on a security whose pay-off is certain.
- **Sales Revenue Maximisation -** An objective of seeking to maximise total sales revenue, it is achieved where marginal revenue is zero. Often used as an alternative to profit maximization.
- **Sample Mean -** The sample mean is an estimator available for estimating the population mean. It is a measure of location, commonly called the average.
- **Savings Function -** How much will be saved at different levels of disposable income.
- **Savings -** That part of disposable income (income less direct taxes plus state benefits) not spent on goods and services. Savings are therefore any income that is not spent, but put aside. In an economic sense we would also include buying shares or securities as part of this. Savings are a leakage or withdrawal from the circular flow.
- **Say's Law -** Say's Law was developed by French economist Jean-Baptiste Say. It states "Supply creates its own demand". This view is one adopted by classical economists to justify their argument that it is most important to improve the supply-side of the economy through supply-side policies. If this is done then the extra output will be demanded.
- **Scarcity -** A lack of resources to meet all consumer wants.
- **Schumacher -** A German economist who argued that small scale production has a number of advantages and that developing countries should not be burdened with high debt repayments.
- **Search Unemployment -** A form of frictional unemployment when workers do not accept the first job offered but remain unemployed while searching for a better job.
- **Seasonal Adjustment -** A process of estimating seasonal effects and removing them from the original data.
- **Secondary Banking System -** Financial institutions which deal mainly with companies.
- **Secondary Data -** Existing published information.
- **Secondary Market -** The purchase or sale of securities between the time of their initial issuance and before they mature. Many money market instruments are sold and bought several times by different investors before they mature.
- **Secondary Sector -** That part of the economy concerned with the manufacture of goods.
- **Sectoral Accounts -** See appropriation accounts.
- **Sectors -** The economy is divided into a number of categories in the National Accounts. These Sectors are Households and Non Profit Institutions Serving Households (NPISH), Non-Financial Corporations, Financial Corporations, and General Government. The Rest of the World is treated as a sector in respect of its dealings with the United Kingdom.
- **Securities and Exchange Commission (SEC) -** A US federal agency that regulates and supervises the selling of securities to prevent fraud and unfair practices and to maintain fair and orderly markets.
- **Securities Lending -** Security lending is when one broker or dealer lends a security to another for a fee. This is the process that allows short selling.
- **Securitisation -** Turning something into a security. For example, taking the debt from a number of mortgages and combining them to make a financial product which can then be traded. Banks who buy these securities receive income when the original home-buyers make their mortgage payments.
- **Security -** Essentially, a contract that can be assigned a value and traded. It could be a stock, bond or mortgage debt, for example.
- **Seller's Market -** The quantity of goods for sale exceeds the amount consumers are willing and able to buy at the current market price. Prices are high as a result.
- **Shadow Prices -** Estimated prices in situations where market prices do not exist.
- **Shares -** Securities issued by companies as a way of raising long term capital. Holders are owners of the company.
- **Shock -** Any unforeseen or unanticipated event or occurrence that impinges on the normal working of an economic system.
- **Short Run -** The period of time in which at least one factor of production is fixed.
- **Short Selling -** A technique used by investors who think the price of an asset, such as shares, currencies or oil contracts, will fall. They borrow the asset from another investor and then sell it in the relevant market. The aim is

to buy back the asset at a lower price and return it to its owner, pocketing the difference. Also known as Shorting.

- **Shortage -** To maintain the interest rate set by the Monetary Policy Committee, the Bank of England ensures that each day there is a shortage of liquidity in the money markets. They then relieve this shortage through "repos" - sale and repurchase agreements.
- **Sight Deposit -** A deposit of money in a bank or other financial institution that can be withdrawn without notice.
- **Single Currency -** A situation in which separate countries agree to use the same currency.
- **Single Market -** The single market came into effect in January 1993 and guarantees the free movement of people, goods, services and capital in the EU.
- **Skimming -** A pricing policy sometimes used by companies introducing a new product. A high price is set to ensure large profits are made before the competitors are able to produce a similar product.
- **Slumpflation -** Occurs when there is high inflation, high unemployment and negative growth.
- **SNA93 -** System of National Accounts.
- **Social Benefits -** The total benefits of an economic activity to both the individual and the spillover effects to third parties. Social benefits are the total of private benefits and any external benefits.
- **Social Capital -** The stock of society's assets which provide a service.
- **Social Costs -** The total costs of an economic activity on both the individual and the spillover effects on third parties. Social costs are the total of private costs and any external costs.
- **Social Marginal Cost -** The full costs to society of one extra unit.
- **Social Security -** All social security funds at all levels of government. Social security funds are defined as social insurance schemes covering the community as a whole.
- **Socially Efficient Output -** This occurs when the full opportunity cost of the extra unit equal the value placed by society on its consumption.
- **Soft Loan -** A loan made to a country on a concessionary basis such as a lower rate of interest.
- **Sole Proprietor -** The person owns a private business. Sometimes called a 'sole trader'. The sole trader may employ other people, but alone bears the financial risks of the business.
- **Sole Trader -** Where one person owns a private business. The sole trader may employ other people, but bears the financial risks of the business alone.
- **Span of Control -** The number of staff working under a supervisor or manager.
- **Spare Capacity -** When a firm or economy is able to produce more with existing resources.
- **Special Deposits -** The compulsory loans which the Bank of England can call for from the retail banks thereby reducing their liquid assets.
- **Special Drawing Rights (SDR) -** A form of international money created by the IMF which is acceptable in settlement of debts between countries.
- **Specific Tax -** A fixed tax per unit. A specific tax will have the effect of shifting a supply curve vertically upwards by the amount of the tax.
- **Speculation -** The act of taking action in anticipation of an event taking place, e.g. buying dollars in anticipation that their foreign exchange value will rise, selling shares in anticipation of a fall in their prices and possibly with a view to buying them back later.
- **Speculative Demand/Motive -** The desire to hold wealth as money in order to take advantage of changes in the price of bonds or any other asset thought likely to appreciate rapidly.
- **Spillover Effects -** Positive and negative externalities.
- **Spot Exchange Rate -** The spot rate is the exchange rate existing in the market at any given moment in time. It is the rate you would be able to buy foreign currency at "now". This is in contrast to the forward rate which is a predicted rate for a time in the future.
- **Spot Market -** That part of the foreign exchange market concerned with the buying and selling of currencies for immediate use.
- **Spot Price -** The selling price of a commodity (oil, soy beans, currency, etc.) for immediate rather than forward delivery.
- **Spread -** The difference in yield between two financial instruments, e.g. in a swap of different securities. Swaps are agreements between at least two counter-parties to exchange cash flows in the future according to a pre-specified formula. They can therefore be regarded as portfolios of forward contracts. The most common one is an agreement on the exchange of a fixed rate for a floating rate contract.
- **Stability and Growth Pact -** The Pact is the framework, adopted in 1997, for the co-ordination of fiscal policy across EU States. It stipulates that Member States adhere to the medium-term

objective of budgetary positions "close to balance or in surplus". This is judged to be necessary to allow automatic stabilisers to work during a normal downturn without taking the budget deficit above the 3 per cent of GDP limit. A general government deficit exceeding this threshold can lead to pecuniary penalties unless the European Council judges it to be temporary and there are special circumstances.

- **Stagflation** – put simply, stagflation is an economic state in which inflation combines with a downturn in the economy – "stagnation with inflation". It is an economic downturn characterised by the simultaneous existence of stagnation and persistent and intractable inflation. Stagflation occurs when the economy isn't growing but prices are - not a good situation for any country.
- **Stagnation -** A negative level of economic growth - the economy shrinking. If this only happens in the short-term it may be called a recession, but if it lasts longer, then it may be referred to as stagnation.
- **Standard Economic Regions –** The UK is divided into eleven standard economic regions.
- **Standard For Deferred Payments -** The standard way, in a given market, to settle a debt.
- **Standard Industrial Classification 2003 (SIC 2003) -** The Standard Industrial Classification (Revised 2003) is a way of categorising economic activities into a common structure. At the highest level there are seventeen classifications (A-Q) where activities such as Manufacturing (D) and Construction (F) are classified. These sections are further broken down into divisions, classes and subclasses which are represented in a numbered system.
- **Standard Regions -** The 11 government defined regions of the UK e.g. the South East, Wales and Yorkshire and Humberside.
- **Standardised Unemployment Rate -** Unemployment measured as far as possible across countries according to ILO definitions of unemployment and labour force.
- **Standards of Living -** A measure of economic welfare e.g. of real per capita income.
- **Star -** A product which has high growth and high market share. See Boston Matrix.
- **Statistical Inference -** Statistical inference makes use of information from a sample to draw conclusions (inferences) about the population from which the sample was taken.
- **Statistics -** Used in the singular - the area of study that has as its object the collection and arrangement of numerical facts or data, whether relating to human affairs or natural phenomena. Used in the plural - numerical facts or data collected and classified.
- **Stock Appreciation -** The increase in the value of inventories brought about by inflation.
- **Stock Exchange -** A market for the sale and purchase of shares and securities. Modern stock markets are not necessarily located in a particular building, but consist of traders who are linked by computer terminals. Companies can use the stock market to sell new shares and raise money for investment. There is also a market in gilt-edged securities as part of the stock exchange.
- **Stock Figure of Unemployment -** The number of people without a job seeking employment at a given moment in time.
- **Stock Value -** An amount at a given moment in time, e.g. wealth.
- **Stockpiling -** Building up a stock of goods. This may be involuntary (caused by overproduction e.g. coal) or a matter of policy e.g. in industries where demand is highly seasonal or in defence industries. Stockpiles represent costs that have been incurred but not recovered.
- **Stop-Go Cycles -** Fluctuations in economic activity caused by contractionary and expansionary government policy.
- **Structural Adjustment Programmes -** A programme of free market and supply side reforms that multilateral agencies such as the IMF lay down as conditions for lending funds.
- **Structural Surpluses -** Supply exceeding demand because of the imposition of a minimum price above the equilibrium.
- **Structural Unemployment -** The rate of unemployment consistent with constant wage inflation (NAWRU), or constant price inflation (NAIRU), given current economic conditions.
- **Structural Unemployment -** Those out of work because of a permanent decline in the demand for an industry's product.
- **Sub-Prime Mortgages and Loans -** The phrase 'sub-prime' in relation to mortgages, sometimes also referred to as "non conforming mortgages", generally refers to those mortgages targeted at consumers with impaired or low credit ratings (with payment delinquencies and possibly county court

judgments, and bankruptcies) who may find it difficult to obtain finance from traditional sources. These mortgages are also often used to consolidate existing secured and non-secured debts. These borrowers may also show reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. These loans have a higher risk of default than loans to prime borrowers and this is reflected in high interest and other penal terms. Some sub-prime lenders are independent, but increasingly they are affiliates of mainstream lenders operating under different brand names.

- **Subsidy -** A payment to producers or consumers designed to encourage an increase in output.
- **Subsistence -** The minimum income needed to survive.
- **Substitutes -** Substitute goods are often termed as having competitive demand. The consumer can swap between the two goods and maintain the same degree of satisfaction. Some goods have very close substitutes, while others do not. An indication of the goods being substitutes is the cross price elasticity of demand. If the CPED is positive then the two goods are substitutes. If the value is greater than one, then they are close substitutes.
- **Substitution Effect -** The substitution effect occurs when the price of a good falls and the consumer substitutes more of this product for others
- **Supply Curve -** A curve showing the relationship between the price of a good and the quantity of the good supplied by producers (firms). The curve is upward sloping due to the higher price being an incentive to supply more. A supply curve can be applied to the individual firm, groups of firms, a market or markets.
- **Supply Lag -** A time lag between a good or service being demanded and the actual supply of that good or service.
- **Supply Shock -** An unplanned change in supply usually occurring because of changes in weather conditions or an external change outside the control of the company or economy.
- **Supply Side Economics -** The branch of economies concerned with the productive potential of the economy and how to increase it.
- **Supply Side Policy -** Government policies which create incentives for individuals and firms to increase their productivity and improve the workings of markets. In this way they improve the capacity of the economy to produce and so shift the aggregate supply curve to the right. This should enable the economy to grow in a non-inflationary way.
- **Supply -** The amount of goods which producers are both willing and able to sell at a given price.
- **Sustainable Development -** Development where consideration is given to the quality of life of future as well as current generations.
- **Sustainable Growth -** Sustainable growth is economic growth that can continue over the long-term without non-renewable resources being used up.
- **Swap -** An exchange of securities between two parties. For example, if a firm in one country has a lower fixed interest rate and one in another country has a lower floating interest rate, an interest rate swap could be mutually beneficial.
- **Sweezey Model -** The kinked demand curve operating under conditions of oligopoly.
- **Symmetrical Target -** A symmetrical target for inflation is one where the aim is to achieve the exact rate. If inflation was under the target, policies would aim to expand the economy, whereas if inflation was over the target, policies would aim to restrain the level of demand to reduce inflation. The target for inflation set by the government for the Bank of England is a symmetrical target. This is in contrast with a target for inflation that may be "...% or less".
- **Systemic Risk -** One of the Core Purposes of the Bank of England is to maintain the stability of the financial system as a whole. When looking at this they are looking for things that may cause systemic risk. That is the risk that an event or the failure of a financial institution may cause a risk to other perfectly healthy institutions because of the links between them. In other words - risks to the whole system.
- **Takeover -** When one company buys a controlling interest in a second against the wishes of that company's directors.
- **Target Interest Rate -** A given level of an interest rate - e.g. overnight lending rate, repo rate, etc. - with which the central bank seeks to influence short term interest rates, as part of its monetary policy strategy.
- **Target Variables -** Variables, such as the money supply or exchange rate through which the government attempts to achieve its objectives.
- **Tariff -** A tax imposed on a good imported into a country.
- **Tariffication -** The replacement of quantitative restrictions on imports with their estimated tariff equivalent.

- **Tax And Price Index (TPI) -** Measures average household purchasing power, including the effects of changes in direct taxes as well as prices.
- **Tax Base -** The coverage of what is taxed.
- **Tax Incidence -** The burden of a tax.
- **Tax Threshold -** The point at which a tax begins, or ceases, to operate. Usually used in relation to taxes on income.
- **Technical Barriers to Trade -** Technical regulations, minimum standards and certification systems for health, safety and environmental protection and to enhance the availability of information about products, which may result in the erection of technical barriers to trade (TBTs).
- **Technical Economies of Scale -** Lower unit costs which come about when cost is not related to size on a 1:1 basis. For example, doubling the size of a lorry does not necessarily double cost.
- **Technical Efficiency -** When a firm produces a given quantity of output with the minimum number of inputs.
- **Terms of Trade -** The relationship between the weighted average price of exports and imports, expressed as an index value.
- **Tertiary Sector -** That part of the economy concerned with the provision of services.
- **Theory of Contestable Markets -** What is important is not actual but potential competition.
- **Tied Aid -** Bilateral Foreign aid that is given on the condition that the recipient country uses the funds to purchase goods and services from the donor country.
- **Tier 1 Capital** - a calculation of the strength of a bank in terms of its capital, defined by the Basel Accords, typically comprising ordinary shares, disclosed reserves, retained earnings and some preference shares.
- **Time Accounts -** Deposits in bank and building societies which earn interest but which are subject to a period of notice before withdrawal.
- **Time Deposits -** A deposit of money with a bank or other financial institution that requires notice before it can be withdrawn.
- **Time Lags -** Delays before changes in fiscal policy take effect.
- **Time to Maturity -** The length of time until the contract's expiration date.
- **TIN -** Tax identification number.
- **Tobin's Q Ratio** – this is assets divided by replacement value: the market value of a company's assets divided by the replacement value of the company's assets. Tobin's Q is a ratio comparing the value of the stocks of a company listed in the financial market with the value of a company's equity book value. Another use for Q is to determine the valuation of the market as a whole. The formula for this is: value of shares on stock market/corporate net worth. The ratio was developed by James Tobin (Tobin 1969). Tobin's Q is calculated by dividing the market value of a company by the replacement value of the book equity: EMV+LBV divided by EBV+LBV (Where EMV = Equity Market Value, LBV = Liabilities Book Value and EBV = Equity Book Value).
- **Tobin Tax -** The header commonly given to the proposal for levying all foreign exchange transactions.
- **Total Cost Curve -** Curves showing the total cost of producing an output.
- **Total Costs -** The amount spent on producing a given level of output. The total costs are calculated as total fixed costs plus total variable costs.
- **Total Domestic Expenditure -** The total amount spent in an economy in a year.
- **Total Domestic Income -** The total amount earned by factors of production in a year.
- **Total Final Expenditure -** Total domestic expenditure plus exports.
- **Total Product -** Total output.
- **Total Revenue Curve -** A curve showing the total revenue earned from the sale of different levels of output.
- **Total Utility -** The amount of satisfaction obtained by consuming units of a good.
- **Toxic Debts -** Debts that are very unlikely to be recovered from borrowers. Most lenders expect that some customers cannot repay; toxic debt describes a whole package of loans where it is now unlikely that it will be repaid.
- **Tradable Permits -** Licences that permit firms to pollute up to a certain level. They can be bought and sold.
- **Trade Balance -** The balance between exports and imports of total goods and services.
- **Trade Creation -** The increased trade that occurs between member countries of trading blocs usually resulting from economies of scale following the enlargement of the market.
- **Trade Cycle -** The tendency of economies to move, over time, through periods of boom and slump that occurs

when real GDP moves away from its trend path. The trade cycle is the fluctuations in the rate of economic growth that take place in the economy. It is the aim of all governments to try to dampen the effects of the trade cycle and get more balanced long-term growth. The peak of the trade cycle is usually referred to as a boom, and the trough as a recession or depression.

- **Trade Diversion -** The decrease in trade following the formation of a trading bloc as trade with low cost non-trading bloc members is replaced by trade with relatively high cost trading bloc members.
- **Trade in Goods -** Covers general merchandise, goods for processing, repairs on goods, goods procured in ports by carriers and commodity gold. General merchandise is defined as covering, with a few specific exceptions, all movable goods for which actual or imputed changes of ownership occur between residents and non-residents.
- **Trade in Services -** Provision of services between UK residents and non-residents, and transactions in goods which are not freighted out of the country in which they take place, e.g. purchases by tourists etc.
- **Trade Liberalisation -** The removal of barriers to trade such as import quotas and tariffs.
- **Trade Restrictiveness Index (TRI) -** An indicator of welfare losses caused by commercial policy instruments. The TRI weights trade policy measures by their associated welfare losses to compile a single synthetic measure. Implementing this technique is demanding in terms of data requirements.
- **Trade War -** A situation where countries retaliate against import restrictions imposed on them by increasing their import restrictions against the countries concerned.
- **Trade-Off -** What has to be sacrificed in order to obtain goods, it is equivalent to opportunity cost.
- **Trading Bloc -** A regional group of countries co-operating together to liberalise trade between each other.
- **Tranches -** Percentage of quotas which IMF members are permitted to borrow.
- **Transaction Costs -** All the costs associated with buying and selling a good e.g. the cost of finding out information.
- **Transaction Tax -** A tax levied on the transaction of securities.
- **Transactions Demand/Motive -** The desire to keep money to make every day purchases.
- **Transfer Earnings -** The minimum payment needed to keep a factor of production in its current employment.
- **Transfer Payments -** Payments for which no good or service is exchanged. In other words, money has simply been transferred from one person in society to another. This includes things like benefits, pensions and lottery payments. A significant proportion of government expenditure is on transfer payments.
- **Transfer Pricing -** Setting internal prices to charge other branches of the same company. The practice that multinational enterprises adopt of organising their accounting practices so as to declare high incomes and profits in geographical areas with low taxation rates.
- **Transformation Curve -** Another name for a production possibility curve.
- **Transmissions Mechanism -** The link between a change in an economic variable and economic activity.
- **Transnational Corporations -** A business organisation operating in a number of countries.
- **Treasury Bill Tender -** The sale of treasury bills.
- **Treasury Bill -** A short-term debt issued by a national government with a maximum maturity of one year. Treasury bills are sold at discount, such that the difference between purchase price and the value at maturity is the amount of interest. The size of the issue depends on how much they need. The Bills are a promise to pay (an IOU) and usually mature after 91 days. They are offered to the money markets by a weekly tender.
- **Treasury Bond -** A bond issued by a national government. Treasury bonds normally carry a higher rating than local government or corporate bonds, thereby offering a lower yield.
- **Treasury Note -** An intermediate interest bearing obligation of a national government with a maturity ranging from one to five years.
- **Treaties of Rome -** These are the treaties that led to the formation of the EEC (European Economic Community) and EURATOM (European Atomic Energy Community). There were originally six countries who signed; France, Belgium, Germany, Italy, Luxembourg and Holland. They came into force on 1 January 1958.
- **Treaty of Amsterdam -** The Treaty of Amsterdam has been in force since 1 May 1999 and it modified significantly previous EU treaties. It granted new and important responsibilities to the European Parliament and widened the scope of decisions which can be taken

by the Council of Ministers.

- **Trend -** A long term movement in a time series. It is the underlying direction (an upward or downward tendency) and rate of change in a time series, when allowance has been made for the other components.
- **Trickle Down -** The process whereby the economic gains from economic growth pass down throughout the entire society eventually giving rise to development.
- **Underlying Rate of Inflation -** The rate of inflation having allowed for one-off, abnormal or distorting factors. The underlying rate of inflation is an adjusted measure of inflation that removes some of the distortions in the Retail Price Index. It is also known as RPIX.
- **Underproduction -** When production is below the socially optimum level.
- **Underwriters -** In the context of a rights issue, the institution pledging to purchase a certain number of shares if not bought by the public.
- **Unemployment Rate -** The number of workers without a job who are willing and able to work, expressed as a percentage of the total working population.
- **Unemployment Trap -** A situation where people are worse off when they gain employment.
- **Unit Cost -** Average cost, i.e. total cost divided by output.
- **Unit Labour Costs -** Wages and salaries including employer contributions to social security per unit of output.
- **Unit of Account -** A standard monetary unit of measurement of the market value/cost of goods, services, or assets, e.g. £ and $.
- **United Nations Development Programme (UNDP) -** The United Nations Development Programme (UNDP) is the UN's principal provider of development advice, advocacy and grant support.
- **United Nations Industrial Development Organization (UNIDO) -** UNIDO, the United Nations Industrial Development Organization, has been working with governments, business associations and individual companies to solve industrial problems - and equip them to help themselves - for more than 30 years.
- **Unlimited Liability -** Owners of a business may have to sell off some or all of their personal possessions to meet the debts of the business because there is no limit to the amount of claims that can be made against them.
- **Unwind -** To sell something that you have previously bought, or vice versa. When administrators are called in to a bank, they must do the unwinding before creditors can get any money back.
- **Urbanisation -** The economic and demographic processes involved in the growth of towns and cities.
- **Utility -** A measure of the relative satisfaction from, or desirability of, consumption of various goods and services. Shortened to Utils.
- **Value Added Tax (VAT) -** A tax on the value added at each stage of production or delivery of services, namely the difference between the value of final goods minus the cost of buying raw materials and intermediate goods. It also applies to services.
- **Value-Added -** The difference between the value of final goods minus the cost of buying raw materials and intermediate goods.
- **Value at Risk (VaR)** - a technique used to estimate the probability of portfolio losses based on the statistical analysis of historical price trends and volatilities. In practice, it is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. Although VaR is a very general concept that has broad applications, it is most commonly used by security firms or investment banks to measure the market risk of their asset portfolios (market value at risk). VaR is widely applied in finance for quantitative risk management for many types of risk. VaR does not give any information about the severity of loss by which it is exceeded. Other measures of risk include *volatility/standard deviation, semi-variance* (or *downside* risk) and *expected shortfall*.
- **Variable Costs -** Production expenses (costs) that are dependent on the level of output. In other words, if output increases then the variable costs will increase.
- **Variable Factor -** A variable factor is a factor of production whose quantity can be varied in the short run. We would normally expect labour and raw materials to be variable factors.
- **Variable Pricing -** When a firm offers the same goods at different prices for different market sectors.
- **Variable Rate -** An interest rate that may fluctuate over the life of the loan, unlike a fixed rate. A change in the variable rate will affect either the size of the re-payment or the length of the loan.
- **Veblen Good -** A Veblen good (named after an American economist - Thorstein Bunde Veblen) is a good that

may have an upward-sloping demand curve because of conspicuous consumption. In other words people may buy more of the good because it is more expensive.

- **Velocity of Circulation -** The velocity of circulation is the number of times on average each pound is spent on transactions. So if, for example, there was spending in an economy of 400m and there was a money supply of 100m, then each pound must have been used on average 4 times. The velocity of circulation is 4. The velocity of circulation is an important part of the Fisher Equation of Exchange.
- **Vega** - a measure of the sensitivity of an option or warrant price to changes in the volatility of the underlying asset.
- **Vertical Equity -** Justice or fairness in how individuals who are in different circumstances are treated e.g. in linking the amount of tax paid to personal income.
- **Vertical Integration -** Where firms at different stages of the production chain merge together.
- **Visible Balance -** The difference between a country's income and expenditure on goods such as cars.
- **Visible Trade -** The value of tangible export minus tangible imports i.e. balance of trade.
- **Volatility -** A measure of the risk or uncertainty faced by participants in financial markets.
- **Voluntary Export Agreements (VEA) -** Either an agreement between a producer and the government to limit the export of a good that is required for the home market, or, more usually, an agreement between one country and another to limit their exports to each other of certain goods.
- **Voluntary Export Restraints (VER) -** Arrangements between exporting and importing countries in which the exporting country agrees to limit the quantity of specific exports below a certain level in order to avoid imposition of mandatory restrictions by the importing country.
- **Voluntary Unemployment -** Voluntary unemployment exists when people have chosen not to work because they do not feel that wages at the existing equilibrium are high enough to justify them working. They may prefer instead to receive benefits.
- **Wage Differentials -** The difference in wages between workers in different occupations, age groups, industrials, areas etc.
- **Wage Drift -** The difference between basic pay and total earnings (including overtime, bonuses etc.)
- **Wage-Price Spiral -** A wage-price spiral can occur when workers demand a pay rise above inflation. This will increase the firm's costs and mean that they in turn have to put their prices up further if they are to maintain their profit margin.
- **Wage-Wage Spiral -** When a wage increase in one industry sets off a series of wage claims in other industries so as to maintain differentials.
- **Wants and Needs -** The desire for goods and services.
- **Warrants -** A document entitling the bearer to receive shares, usually at a stated price.
- **Wealth Effects -** Effects on private spending arising from a change in wealth. Wealth effects are usually associated with changes in the value of equity, bonds and real estate.
- **Wealth -** A stock of all those assets capable of earning an income. Wealth can be human or material.
- **Weight-Gaining Industries -** Industries that use compact raw materials to produce a bulky finished product.
- **Weight-Losing Industries -** Industries that use bulky raw materials to produce a compact finished product.
- **Welfare Economics -** A framework for deciding on the optimal (best) use of scarce resources.
- **Welfare Loss -** A situation where marginal social benefit is not equal to marginal social cost and society does not achieve maximum utility.
- **Wholesale Banking -** Wholesale banking refers to banking by institutions who deal with other financial institutions or large firms.. Merchant banks would usually be considered wholesale banking institutions as they deal only with large firms and other banks and not usually with individual customers.
- **Wild Cards -** Any product that has a low market share within an expanding market.
- **Withdrawals -** Income not passed on by consumers in the circular flow e.g. savings, taxation or imports. Withdrawals are sometimes called leakages.
- **Worker Co-operative -** A worker-owned business where the employees all contribute to the running of the firm and share in its profits.
- **Working Population -** The number of people who are eligible and willing to work.
- **World Bank -** A bank whose focus is on foreign exchange reserves and the

balance of trade. It gives long term loans to member countries for high priority infrastructure, agricultural, industrial and educational projects.

- **World Trade (Growth of) -** Calculated as the arithmetic mean of the growth of world import volumes and world export volumes.
- **World Trade Organisation (WTO)** - International organisation dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. The system, known as the multilateral trading system, is centred around WTO agreements, negotiated and signed by a large majority of the world's trading nations, and ratified in their parliaments. These agreements are the legal ground-rules for international commerce. Essentially, they are contracts, guaranteeing member countries important trade rights. They also bind governments to keep their trade policies within agreed limits. The agreements were negotiated and signed by governments. But their purpose is to help producers of goods and services, exporters, and importers conduct their business.
- **Write-Down -** Reducing the book value of an asset to reflect a fall in its market value. For example, the write-down of a company's value after a big fall in share prices.
- **X Inefficiency -** When a firm fails to produce on the lowest possible average and marginal cost curves. X-inefficiency is perhaps most likely in a situation where there is not enough competition, like monopoly. In these circumstances forms may not be stretched as there is no competition and so some "organisational slack" may creep in. This means that resources are not being used as efficiently as possible. X-inefficiency will increase costs because of a lack of competitive pressure.
- **Yield Curve -** A curve that traces yields on securities with varying maturities. The slope of the yield curve is an indication of the stance of monetary policy. Under normal conditions, interest rates for long term rates are likely to be higher than short-term rates, resulting in an upward sloping yield curve. An inverted yield curve occurs when short-term interest rates rise above long-term rates, usually due to the central bank raising short-term interest rates to prevent the economy from overheating.
- **Yield Spread -** The difference in the rate of return in two different investments. If Bond A earns a return of 10% and Bond B 7%, the yield spread would be three percentage points.
- **Yield -** The net present rate of return on an investment. For a bond the current yield is the coupon rate of interest divided by the purchase price. A yield is inversely related to the price of a bond, such that as the price of the bond goes up, its yield declines. The yield of a gilt-edged security would therefore be the income you got from it each year, as a percentage of the price you paid for it.
- **Zero Growth -** A situation where the economy does not grow at all. This can also be termed stagnation if it continues for very long.
- **Zero Sum Game -** A zero sum game occurs when any gain made by one player is exactly balanced by losses to other players.

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

If you would like to receive further information about this subject or other publications, please call us – see our contact details on the next page.

Important Notice

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