

CHAPTER 1

Infinite wants

The limitless desires to consume goods and services.

Finite resources

The limited amount of resources that enable the production and purchase of goods and services.

Factors of production

Resources needed to make goods and services: land, labour, capital and enterprise.

Production possibility frontier

The production possibility frontier shows the maximum amount of products that can be produced by an economy with a given amount of resources.

Opportunity costs

The benefits forgone from the next best alternative.

Macroeconomics

The study of how the entire economy works.

Microeconomics

The study of how individuals make economic decisions within an economy.

Planned economy

In a planned economy, the government decides how resources are allocated to the production of particular products.

Market economy

In a market economy, the government plays no role in allocating resources. Instead markets allocate resources to the production of various products.

Mixed economy

In a mixed economy the government and the private sector jointly solve economic problems.

Models or theories

These are frameworks for organizing how we think about an economic problem.

Positive economics

This studies objective or scientific explanations of how the economy works.

Normative economics

This offers recommendations based on personal value judgements.

Positive relationship

A positive relationship exists between two variables if the values for both variables increase and decrease together.

Negative relationship

A negative relationship exists between two variables if the values for one variable increase (decrease) as the value of the other variable decreases (increases).

Time series data

The measurements of one variable at different points in time.

Cross-sectional data

The measurements of one variable at the same point in time across different individuals.

Panel data

This combines cross-sectional and time series data.

Percentage

This measures the change in a variable as a fraction of 100.

Index numbers

These are used to transform a data series into a series with a base value of 100.

CHAPTER 2**Demand curve**

The demand curve illustrates the relationship between price and quantity demanded of a particular product.

Substitutes

These are rival products; for example, a BMW car is a substitute for a Mercedes, or a bottle of wine from France is a substitute for a bottle from Australia.

Price expectations

Beliefs about how prices in the future will differ from prices today.

Law of demand

The law of demand states that, *ceteris paribus*, as the price of a product falls, more will be demanded. *Ceteris paribus* means all other things being equal.

Elasticity

A measure of the responsiveness of demand to a change in price.

Income elasticity

This measures the responsiveness of demand to a change in income.

Cross price elasticity

This measures the responsiveness of demand to a change in the price of a substitute or complement.

Total revenue

Price multiplied by number of units sold.

Consumer surplus

The difference between the price you are charged for a product and the maximum price that you would have been willing to pay.

CHAPTER 3**Fixed costs**

These costs are constant. They remain the same whatever the level of output.

Variable costs

These costs change or vary with the amount of production.

Short run

A period of time where one factor of production is fixed. We tend to assume that capital is fixed and labour is variable.

Total product

The total output produced by a firm's workers.

Marginal product

The addition to total product after employing one more unit of factor input.

Total costs

These are simply fixed costs plus variable costs.

Average total cost

This is calculated as total cost divided by the number of units produced.

Average variable cost

This is calculated as total variable cost divided by the number of units produced.

Average fixed cost

This is calculated as total fixed costs divided by the number of units produced.

Marginal cost

The cost of creating one more unit.

Economies of scale

Long-run average costs fall as output increases

Indivisibilities

Assets that cannot be divided into smaller units.

Minimum efficient scale (MES)

The output level at which long-run costs are at a minimum.

CHAPTER 4**Supply curve**

This depicts a positive relationship between the price of a product and firms' willingness to supply the product.

Market equilibrium

This occurs at the price where consumers' willingness to demand is exactly equal to firms' willingness to supply.

Disequilibria

In this situation, at the current price the willingness to demand will differ from the willingness to supply.

Separating equilibrium

This is where a market splits into two clearly identifiable sub-markets with separate supply and demand.

Pooling equilibrium

A market where demand and supply for good and poor products pools into one demand and one supply.

Gresham's Law

This states that an increasing supply of bad products will drive out good products from the market.

Input markets

These are where factor inputs, such as land, labour, capital or enterprise, are traded.

CHAPTER 5

Average revenue

The average price charged by the firm and is equal to total revenue/quantity demanded: $(PQ)/Q$.

Marginal revenue

The revenue received by selling one more unit of output.

Marginal profit

The profit made on the last unit and is equal to the marginal revenue minus the marginal cost.

Perfect competition

A highly competitive market place.

Monopoly

A market place supplied by only one competitor, so no competition.

Oligopoly

A market that consists of a small number of large players.

Market structure

The economist's general title for the major competitive structures of a particular market place.

Barriers to entry

These make entry into a market by new competitors difficult.

Exit barriers

These make exit from a market by existing competitors difficult.

Perfect information

Assumes that every buyer and every seller knows everything. No one has an informational advantage.

Price taker

A firm is this if it accepts the market price.

Supernormal profits

These exist if the return to investors or shareholders is in excess of normal economic profits.

Normal economic profits

These are equal to the average rate of return which can be gained in the economy.

Productive efficiency

This means that the firm is operating at the minimum point on its long-run average cost curve.

Allocative efficiency

This occurs when price equals marginal cost, or $P = MC$.

Switching costs

The costs of moving between products.

CHAPTER 6**Strategic interdependence**

Firms within an oligopoly are seen to be strategically interdependent. The actions of one firm will have implications for its rivals.

Exogenous cost

Cost to the firm outside its control.

Endogenized cost

When firms inside the industry have strategically influenced the level and nature of cost.

Sunk cost

An expenditure that cannot be regained when exiting the market.

Contestable market

A market where firms can enter or exit the market freely.

Kinked demand curve

When price rises will not be matched by rivals, but price reductions will be matched.

Game theory

This seeks to understand whether strategic interaction will lead to competition or cooperation between rivals.

Single period game

In a single period game, the game is only played once. In a repeated game, the game is played a number of rounds.

Credible commitment

A credible commitment or threat has to be one that is optimal to carry out.

CHAPTER 7**Vertical chain of production**

This encapsulates the various stages of production from the extraction of a raw material input, through the production of the product or service, to the final retailing of the product.

Vertically integrated

A company is said to be vertically integrated if it owns consecutive stages of the vertical chain.

Horizontal growth

This occurs when a company develops or grows its activities at the same stage of the production process.

Diversification

The growth of the business in a related or an unrelated market.

Rationalization

This is associated with cutbacks in excess resources in the pursuit of increased operational efficiencies.

Learning curve

This suggests that as cumulative output increases, average costs fall.

Transaction costs

The costs associated with organizing the transaction of goods or services.

Complete contract

Under a complete contract, all aspects of the contractual arrangement are fully specified.

Hold-up problem

The renegotiation of contracts, linked to asset specificity.

Specific asset

A specific asset has a specific use; a general asset has many uses.

Economies of scope

These are said to exist if the cost of producing two or more outputs jointly is less than the cost of producing the outputs separately.

Diversified portfolio

A portfolio of activities containing a mix of uncorrelated business operations.

CHAPTER 8**Moral hazard**

Occurs when someone agrees to undertake a certain set of actions but then, once a contractual arrangement has been agreed, behaves in a different manner.

Satisficing

The attainment of acceptable levels of performance. Maximizing is the attainment of maximum levels of performance.

Piece rates

These occur when a worker is paid according to the output produced. Under hourly wage rates, workers are paid for time at work.

Externalities

The effects of consumption, or production, on third parties. If production, or consumption, by one group improves the well-being of third parties, then a **positive externality** has occurred. If production, or consumption, by one group reduces the well-being of third parties, then a **negative externality** has occurred.

Marginal private costs

The cost to the individual of producing one more unit of output.

Marginal private benefit

The benefit to the individual from consuming one more unit of output.

Marginal social cost

The benefit to society from the consumption of one more unit of output.

Subsidy

A payment made to producers, by government, which leads to a reduction in the market price of the product.

Competition Commission

The Competition Commission investigates whether a monopoly, or a potential monopoly, acts against the public interest.

CHAPTER 9

Circular flow of income

This shows the flow of inputs, output and payments between households and firms within an economy.

CHAPTER 10

Expectations

Beliefs held by firms, workers and consumers about the future level of prices.

Menu costs

These are associated with the activity and cost of changing prices in shops, price lists and, of course, menus.

CHAPTER 11

Fiscal policy

The government's decisions regarding taxation and spending.

CHAPTER 12

Economic growth

This is measured as the percentage change in GDP per year.

Full employment

This occurs within an economy when all markets are in equilibrium.

CHAPTER 13

Forex markets

These are where different currencies are traded.

Speculative attack

A massive capital outflow from an economy with a fixed exchange rate.

Official financing

The extent of government intervention in the forex markets.

Monetary union

The permanent fixing of exchange rates between member countries.

Hedging

The transfer of a risky asset for a non-risky asset.

CHAPTER 14**Protectionist measures**

These seek to lower the competitiveness of international rivals.

Trade bloc

A region or group of countries that have agreed to remove all trade barriers between themselves.