The Concise McGraw-Hill DICTIONARY OF MODERN ECONOMICS

A Handbook of Terms and Organizations

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An abridged version of *The McGraw-Hill Modern Economics*, Third Edition

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Preface

The Concise McGraw-Hill Dictionary of Modern Economics provides definitions of about 1,100 terms from the fields of economics, econometrics, marketing, and statistics, and descriptions of fourteen federal and international economics organizations. All these definitions and descriptions are exactly the same in content and length as those given in the unabridged edition of the dictionary (published in 1983). There are only two significant differences between this *Concise Dictionary* and the complete work from which it derives. First, the *Concise Dictionary* does not contain most of the section that describes a number of public and private economics and research organizations. We have, however, retained entries for a few key economics and statistical organizations. Second, the *Concise Dictionary* does not contain about 250 terms which were, for the most part, related to the accounting profession and to the insurance industry.

In this dynamic period for the economics profession, long-accepted definitions of economics terms have been drastically altered, old terms have been discarded completely, and new terms have entered the language. These major changes are all reflected in this concise edition. In addition, the bibliographical references that accompany the definitions have been thoroughly updated as an aid to the reader who wants to learn more about a particular subject.

We have tried to explain clearly and concisely the key points of each concept. We have also tried to write simple and lucid definitions of the technical and econometrics terms that form the basis of much theoretical and mathematical analysis currently being propounded.

The *Concise Dictionary* (like the larger work from which it is derived) is a joint product of economists who were connected at one time or another with the economic departments of McGraw-Hill. It does not, however, embody any formal or official expression of McGraw-Hill policy. The authors are solely responsible for the selection of the individual terms and the definitions that accompany them.

I would like to thank William Sabin of McGraw-Hill's Professional and Reference Division for his support in getting this *Concise Dictionary* published. I would also like to thank Anna Shaler and Nancy Warren for their editorial

help in preparing this book for publication. I must also thank my wife, Mickey, for her support and encouragement. And finally, I would like to express appreciation to the teachers of economics and readers of economics throughout the nation and overseas whose suggestions over the years have been incorporated in *The Concise McGraw-Hill Dictionary of Modern Economics*.

Douglas Greenwald

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What the dictionary provides

1. A simple definition of approximately 1,100 frequently used modern economic terms.
2. A detailed description of a few public agencies and organizations concerned with economics, including a few outside the United States.
3. References to both current and original sources of information which provide a more detailed explanation of the terms
4. References to sources of economic data.
5. Tables and diagrams when necessary to enhance the definitions.
6. Whenever possible, description of both sides of any issue that might be subject to controversy.

Who can use the dictionary

1. Students who need an auxiliary reference work for courses in economics and business.
2. Students who are working in applied courses and whose background in economics may be limited or out of date.
3. Students of American history and government.
4. College engineering students who are taking a first course in economics.
5. Heads of household and investors who must understand financial and economic reports.
6. Libraries.
7. Instructors.
8. Foreign students who are unfamiliar with American practice and terminology.
9. High school students.
10. Students who are taking evening courses.
11. Editors of newspapers and periodicals of all types.
12. Business executives.
13. The average individual who would like to know a little bit about a lot of economics.

How they can use it

1. Teachers, students, and the general public can consult it as a reference work.
2. Readers can use the dictionary to develop increased interest in economics and to stimulate a desire to learn more about a specific area of economics.
3. Students and nonstudents of economics can use it to bring their economic thinking up to date.

Contributors

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Part One
TERMS

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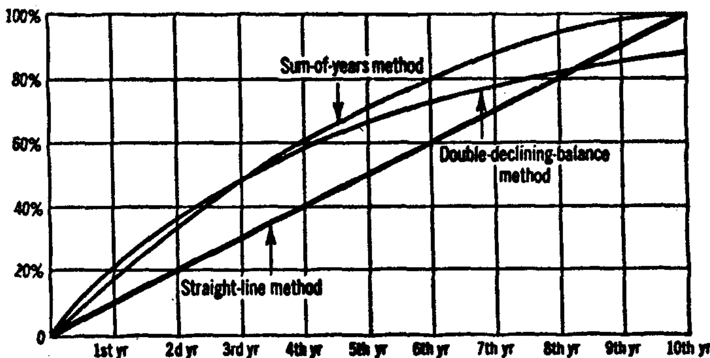
A

ability-to-pay principle of taxation The theory that the tax burden should be distributed according to the individual's ability to pay. It is based on the assumption that those who possess more wealth than others should contribute a relatively larger amount to the support of the government. The obligation to pay is seen as a social or collective responsibility rather than as a personal one. Employing the concept of a diminishing utility of income, the ability-to-pay principle tries to equalize the sacrifice made by each individual in paying taxes. The determination of a tax base capable of measuring an individual's ability to pay is a major problem of this theory. Generally, net money income (with deductions for minimal survival needs) is used as the best measure of this ability. This measure ignores differences in financial commitments, in expectations of future income, and in habits of consumption, however, and thus may not reflect the individual's real ability to pay the tax. Another problem is the determination of a rate schedule which truly equalizes the sacrifices involved in paying a tax. The concept of diminishing marginal utility indicates that a tax based on the ability to pay should be progressive (or at least proportional), but there is no way of determining how steep rate increases should be. Furthermore, the application of a uniform rate to all taxpayers ignores differences among persons in the utility of income. The ability-to-pay principle, regarded by many as the most equitable and just theory of taxation, is incorporated into most of the important U.S. taxes, such as the progressive personal income tax and the inheritance tax. For additional information, see Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice*, McGraw-Hill, New York, 1975.

absolute advantage The ability of a particular country, firm, or worker to supply a product or service at a cost lower than that of a competitor. Most of the world's trade is carried on because of differences in absolute advantage: bananas are bought from Honduras instead of Canada, nylon is purchased from Du Pont rather than General Motors, and even in a small village the watchmaker buys bread from the baker instead of making it. This division of labor is generally advantageous because it forces every country, firm, and

worker to specialize and thus to acquire cost-cutting skills. Nevertheless, competitors faced with the prospect of going out of business sometimes react by requesting government regulations that give them a new lease on life. Such regulations, which reduce the gain obtained from an absolute advantage, are sometimes defended in the name of the infant-industry argument. According to this argument, a protected industry, if allowed to live and grow even when at a competitive disadvantage, may have a chance to develop new markets and new methods that will give it an absolute advantage in the future. See C. P. Kindleberger and P. H. Lindert, *International Economics,* Irwin, Homewood, Ill., 1978.

accelerated depreciation A faster-than-historical rate of depreciation of a fixed asset for income tax purposes. It is a method of depreciation that makes the depreciation allowance, and hence the tax allowance, available earlier in the life of the asset. By using the liberalized provisions for computing depreciation allowances introduced in the U.S. Internal Revenue Code of 1954, a business can recapture almost 50% more of its investment in a new fixed asset during the first half of the asset's useful life than it could when it was limited to straight-line depreciation. In addition, rapid tax amortization certificates, introduced during World War II and the Korean conflict to stimulate defense and defense-supporting investment, permitted companies to depreciate within five years assets that would normally have been depreciated over a longer period. Accelerated depreciation in any form does not increase the total tax-free allowance for capital consumption. For additional details, see Norman B. Ture, *Accelerated Depreciation in the United States, 1954–1960,* National Bureau of Economic Research, New York, 1967.



accelerator theory The theory that a change in the demand for goods induces a change in the amount of machinery needed to produce those goods. Let us assume that a manufacturer of radios needs $3 of capital for $1 of

production, and that annual replacement costs equal 10% of the manufacturer's preceding year's capital stock. The table below shows that the output rises between periods 1 and 2 by $5, and that the manufacturer must expand capacity by spending $15, plus a replacement cost of $30. Thus, a 5% rise in demand induces a 50% increase in investment spending. The accelerator can also cause a violent collapse of investment spending, as shown between periods 3 and 4.

Period	Output of goods	Capital stock required	Addition to capacity	Replacement	Total spending for investment
1	100	300	0	30	30
2	105	315	15	30	45
3	115	345	30	32	62
4	110	330	−15	35	20

The accelerator is particularly important in assessing the business outlook when industry is operating near capacity. At such a time, a small increase in demand can raise investment spending enormously. Five limitations to the accelerator theory should be considered before applying it to practical problems. (1) The theory assumes full-capacity operation at all times. This assumption is obviously untrue in practice, and this is one of the main reasons that capacity statistics have been developed for the economy. (2) The theory, as stated, breaks down because it assumes that gross investment can fall below zero, which is impossible. When the derived demand for capital equipment falls so rapidly that depreciation does not dispose of all the equipment not needed, excess capacity is created. (3) The model does not explicitly include expectations as a factor which may raise or lower capital investment. (4) All the foregoing are limitations to be borne in mind, but they do not destroy the theory. More important is the fact that investment sometimes requires years to be completed, a fact that the theory ignores. Because of this time factor, actual investment may fluctuate less markedly than the theory allows when business goes through the cycle. (5) The principle assumes fixed proportions between output and capital stock. This may not necessarily be true if capital can be worked three shifts during periods of unusually heavy demand instead of the normal one shift. The accelerator principle was introduced by John M. Clark in 1917 to explain proportionately larger variations in investment over the course of a business cycle than had occurred in the output of consumer goods. Interest in the accelerator as a theoretical tool increased after 1936, when it was discovered that it could be combined with the Keynesian consumption function to formulate self-generating models of the business cycle. For further discussion, see John M. Clark, "Business Acceleration and the Law of Demand: A Technical Factor in Economic Cycles,"

Journal of Political Economy, vol. 25, no. 3, March 1917, reprinted in ***Readings in Business Cycles***, McGraw-Hill, New York, 1951; Thomas F. Dernburg and Duncan M. McDougall, *Macroeconomics*, 5th ed., McGraw-Hill, New York, 1976, pp. 272–280.

accord, Treasury-Federal Reserve An agreement by the U.S. Secretary of the Treasury and the Board of Governors of the Federal Reserve System on the "debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the government's requirements and, at the same time, to minimize the monetization of the public debt." The announcement on March 4, 1951, that the Treasury and the Federal Reserve had reached "full accord" in these matters marked the official end of one of the most controversial disputes on monetary policy in the Federal Reserve's history. This dispute concerned the continuation into the 1950s, at the Treasury's behest, of the World War II policy of supporting at par the prices of U.S. government bonds. Before the accord, financial institutions wishing to expand their private lending operations were able to sell their accumulated government bond holdings to the Federal Reserve at par. As a result, the Federal Reserve's ability to employ monetary policy as a weapon against postwar inflation was severely restricted. The additional inflationary pressures created by mobilization for the Korean conflict led to the announced accord and to a decision to abandon the unconditional support of government security prices. For a discussion of the basic questions involved in the controversy, see Lester V. Chandler and Stephen M. Goldfeld, *The Economics of Money and Banking*, 7th ed., Harper & Row, New York, 1977; for an account of events surrounding the accord, see Herbert Stein, *The Fiscal Revolution in America*, University of Chicago Press, Chicago, 1969, chap. 10.

acquisition The taking over of one firm by another. The acquisition of a corporation is usually carried out by the purchase of a controlling portion of its common stock. The acquisition form of merger differs from consolidation, which is a joining of firms into a single consolidated company. It is easier to merge small firms by acquisition, since the capital needed for the takeover is within the resources of the acquiring firm. Consolidation is more common in the merger of large firms, especially since new sources of capital may sometimes be required in merging the given firms into a more highly capitalized corporation. A series of acquisitions by one company may be part of an attempt to secure market control, particularly if legal or other restrictions prevent the consolidation of a large number of firms at one time. For additional details, see Betty Bock, *Mergers and Markets: 7*, Conference Board, Studies in Business Economics, no. 105, New York, 1969.

adjustable-rate mortgages *See* **mortgages, nontraditional.**

administered-price theory A theory that the prices of goods or services are allegedly established by agreement among the executives of large firms

and maintained despite changes in market conditions. Thus, the market forces of supply and demand play little or no role in determining prices. When the demand for a particular product declines, prices remain the same. Because economic activity no longer declines sharply in recession periods, those persons who supposedly administer prices are not under strong pressure to reduce them. Rather, the incentive is to maintain prices, since the pressures from cost-push and from the demand side are generally prevalent. Before World War II, the inflexibility of administered prices was accepted by some economists and government authorities, but it was not until after the war that this inflexibility was considered to be closely related to the degree of market concentration. For further discussion, see Gardiner C. Means, *The Corporate Revolution in America*, Crowell-Collier, New York, 1962.

administrative budget The traditional method of budgeting federal expenditures and receipts in the United States until 1969. The administrative budget includes the collection and distribution of all funds of which the government considers itself the sole owner. The administrative budget concept is roughly consistent with the concept of federal debt subject to limitation and the federal funds part of the unified budget. There are a number of trust accounts, such as those used to finance social security programs, of which the government does not consider itself full owner, and transactions for these accounts are not included in the administrative budget. Certain highway and housing trust funds are also regarded as outside the administrative accounts and are excluded from the administrative budget. The result of these exclusions is that the administrative budget does not present a complete picture of federal government transactions. For additional details, see Gerhard Colm, *The Federal Budget and the National Economy*, National Planning Association, Washington, D.C., 1955.

ad valorem tax A levy based on a fixed percentage of an item's dollar value. Ad valorem is a Latin term meaning "depending on the value of the item." The great advantages of an ad valorem tax over a specific tax (for example, 4 cents per gallon of gasoline) are that it does not erode during inflationary times and that its direct relationship to an item's value makes it more equitable. A disadvantage is that the need to determine the value of the taxable item makes this tax more difficult to compute. Ad valorem taxes include sales taxes, property taxes, and the majority of import duties. See Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice*, McGraw-Hill, New York, 1975; Robert H. Haveman, *The Economics of the Public Sector*, 2d ed., Wiley, New York, 1976.

advertising A method of providing private consumers, businesses, and governments with information about specific goods, services, or opportunities with the ultimate goal of increasing sales. Advertisements convey news about goods and services, including details to show what they are, what they are used for, where they are, and what they cost. Advertising has become an

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