The McGraw-Hill Dictionary of Modern Economics

THIRD EDITION

A HANDBOOK OF TERMS AND ORGANIZATIONS

DOUGLAS GREENWALD
& ASSOCIATES

The McGraw-Hill DICTIONARY OF MODERN ECONOMICS

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Third Edition

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Preface

During the decade of the 1970s, monetarists superseded Keynesians in importance in the economics field. However, in the early 1980s, supply-siders and post-Keynesians have moved to the forefront in the economics profession. In this dynamic period, long-accepted definitions of economic terms have been altered drastically, old terms have been discarded completely, and new terms have entered the language.

These major changes are all reflected in this third edition of the *Dictionary of Modern Economics*. We have deleted approximately 75 terms which are no longer important and have added approximately 100 definitions of terms that have become important. We have also included descriptions of 25 additional economic and research organizations and eliminated a few that are no longer in existence or are of little importance in today's economic world. Moreover, we have thoroughly updated the bibliographical references that accompany the definitions, so that the reader who wants to know more about a particular subject will know where to turn.

In the early stages of revision, we surveyed several economists in business, academia, and government, asking for suggestions to improve the *Dictionary*. Among those who contributed important ideas were Morris Cohen of Morris Cohen and Associates, Professor Jean Namias of Montclair State College, and Robert S. Schulz, a consultant. On the basis of such comments, we decided to eliminate all the charts and many of the tables included in previous editions, largely because the data for these were already out of date before the *Dictionary* was published. We also decided to delete a number of the bibliographic references because they were no longer in print or were not easily obtainable.

This edition remains a joint product of economists affiliated either formerly or presently with the economics department of McGraw-Hill Publications. It does not embody any formal or official expression of McGraw-Hill policy, nor does McGraw-Hill necessarily endorse the programs of any of the private research organizations listed. The authors are solely responsible for the selection of terms and organizations for inclusion in this volume.

The decisions made with regard to changing, eliminating, and adding definitions involved considerable research effort and time. As in the two previous editions, we have tried to explain clearly and concisely the key points of each concept, even though many of the terms are complex and resist simple definition.

I would like to thank William Sabin of McGraw-Hill Book Company's Professional and Reference Book Division for his support while this third edition of the *Dictionary* was being developed. I would also like to thank Anna Shaler and Nancy Warren for their editorial help in preparing the *Dictionary* for publication. Mary McGee and Jane Palmieri of McGraw-Hill also deserve thanks for their secretarial assistance. I must also thank my wife Mickey for her never-failing support and encouragement and for letting me devote so much of our so-called leisure time to this project. And finally, in addition to those whom I can thank by name, I should like to express appreciation to the teachers of economics and to the readers of economics throughout the nation and overseas, whose suggestions over the years since the second edition was published have now been incorporated in this third edition of the *McGraw-Hill Dictionary of Modern Economics*.

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Manhattan Bank and then as a teacher of economics at Rutgers University in Newark, New Jersey. Prior to his current teaching position, he taught at Iona College. He is a member of the American Economic Association, the American Finance Association, and the Royal Economic Society. He is a contributor to the *Encyclopedia of Economics.*

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Contributors

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Contents

What the dictionary provides

1 A simple definition of approximately 1,425 frequently used modern economic terms.

2 A description of approximately 235 private, public, and nonprofit agencies, associations, and research organizations concerned with economics and marketing, including important agencies and organizations 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.

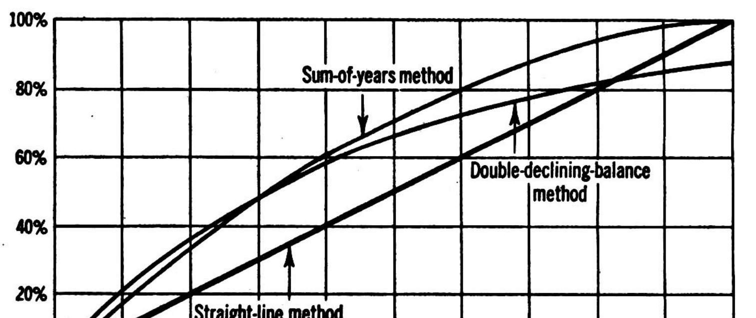
Part One
TERMS

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.

accession rate (hiring rate) The number of additional employees hired during a specific period, expressed as a percentage of total employment. The additions cover all types of employees, including both new and rehired workers on either a permanent or a temporary basis. A significant indicator of overall business activity, the accession rate is classified by the National Bureau of Economic Research as one of its leading indicators. When the rate begins to fall, business may be moving into a recession; when it rises, business may be on the road to recovery. For industry statistics and a more detailed definition of accession rate, see U.S. Department of Labor, *Employment and Earnings,* monthly; for a discussion of the accession rate as an indicator of turning points of business cycles, see R. C. Mendelssohn, "Three BLS Series as Business Cycle Turn Signals," *Monthly Labor Review,* U.S. Department of Labor, September 1959.

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.

accounts payable Liabilities owed by a firm to trade creditors. Usually, accounts payable are limited to the unpaid amounts of goods and services purchased as part of a firm's everyday transactions. The accounts payable are