Glossary

Adam Smith (1723 – 1790) Regarded as the father of modern Economics. Author of *Wealth of Nations*.

Aggregate monetary resources Broad money without time deposits of post office savings organisation (M3).

Automatic stabilisers Under certain spending and tax rules, expenditures that automatically increase or taxes that automatically decrease when economic conditions worsen, therefore, stabilising the economy automatically.

Autonomous change A change in the values of variables in a macroeconomic model caused by a factor exogenous to the model.

Autonomous expenditure multiplier The ratio of increase (or decrease) in aggregate output or income to an increase (or decrease) in autonomous spending.

Balance of payments A set of accounts that summarise a country's transactions with the rest of the world.

Balanced budget A budget in which taxes are equal to government spending.

Balanced budget multiplier The change in equilibrium output that results from a unit increase or decrease in both taxes and government spending.

Bank rate The rate of interest payable by commercial banks to RBI if they borrow money from the latter in case of a shortage of reserves.

Barter exchange Exchange of commodities without the mediation of money.

Base year The year whose prices are used to calculate the real GDP.

Bonds A paper bearing the promise of a stream of future monetary returns over a specified period of time. Issued by firms or governments for borrowing money from the public.

Broad money Narrow money + time deposits held by commercial banks and post office savings organisation.

Capital Factor of production which has itself been produced and which is not generally entirely consumed in the production process.

Capital gain/loss Increase or decrease in the value of wealth of a bondholder due to an appreciation or reduction in the price of her bonds in the bond market.

Capital goods Goods which are bought not for meeting immediate need of the consumer but for producing other goods.

Capitalist country or economy A country in which most of the production is carried out by capitalist firms.

Capitalist firms These are firms with the following features (a) private ownership of means of production (b) production for the market (c) sale and purchase of labour at a price which is called the wage rate (d) continuous accumulation of capital.

Cash Reserve Ratio (CRR) The fraction of their deposits which the commercial banks are required to keep with RBI.

Circular flow of income The concept that the aggregate value of goods and services produced in an economy is going around in a circular way. Either as factor payments, or as expenditures on goods and services, or as the value of aggregate production.

Consumer durables Consumption goods which do not get exhausted immediately but last over a period of time are consumer durables.

Consumer Price Index (CPI) Percentage change in the weighted average price level. We take the prices of a given basket of consumption goods.

Consumption goods Goods which are consumed by the ultimate consumers or meet the immediate need of the consumer are called consumption goods. It may include services as well.

Corporate tax Taxes imposed on the income made by the corporations (or private sector firms).

Currency deposit ratio The ratio of money held by the public in currency to that held as deposits in commercial banks.

Deficit financing through central bank borrowing Financing of budget deficit by the government through borrowing money from the central bank. Leads to increase in money supply in an economy and may result in inflation.

Depreciation A decrease in the price of the domestic currency in terms of the foreign currency under floating exchange rates. It corresponds to an increase in the exchange rate.

Depreciation Wear and tear or depletion which capital stock undergoes over a period of time.

Devaluation The decrease in the price of domestic currency under pegged exchange rates through official action.

Double coincidence of wants A situation where two economic agents have complementary demand for each others' surplus production.

Economic agents or units Economic units or economic agents are those individuals or institutions which take economic decisions.

Effective demand principle If the supply of final goods is assumed to be infinitely elastic at constant price over a short period of time, aggregate output is determined solely by the value of aggregate demand. This is called effective demand principle.

Entrepreneurship The task of organising, coordinating and risk-taking during production.

Ex ante consumption The value of planned consumption.

Ex ante investment The value of planned investment.

Ex ante The planned value of a variable as opposed to its actual value.

Ex post The actual or realised value of a variable as opposed to its planned value.

Expenditure method of calculating national income Method of calculating the national income by measuring the aggregate value of final expenditure for the goods and services produced in an economy over a period of time.

Exports Sale of goods and services by the domestic country to the rest of the world.

External sector It refers to the economic transaction of the domestic country with the rest of the world.

Externalities Those benefits or harms accruing to another person, firm or any other entity which occur because some person, firm or any other entity may be involved in an economic activity. If someone is causing benefits or good externality to another, the latter does not pay the former. If someone is inflicting harm or bad externality to another, the former does not compensate the latter.

Fiat money Money with no intrinsic value.

Final goods Those goods which do not undergo any further transformation in the production process.

Firms Economic units which carry out production of goods and services and employ factors of production.

Fiscal policy The policy of the government regarding the level of government spending and transfers and the tax structure.

Fixed exchange rate An exchange rate between the currencies of two or more countries that is fixed at some level and adjusted only infrequently.

Flexible/floating exchange rate An exchange rate determined by the forces of demand and supply in the foreign exchange market without central bank intervention.

Flows Variables which are defined over a period of time.

Foreign exchange Foreign currency, all currencies other than the domestic currency of a given country.

Foreign exchange reserves Foreign assets held by the central bank of the country.

Four factors of production Land, Labour, Capital and Entrepreneurship. Together these help in the production of goods and services.

GDP Deflator Ratio of nominal to real GDP.

Government expenditure multiplier The numerical coefficient showing the size of the increase in output resulting from each unit increase in government spending.

Government The state, which maintains law and order in the country, imposes taxes and fines, makes laws and promotes the economic wellbeing of the citizens.

Great Depression The time period of 1930s (started with the stock market crash in New York in 1929) which saw the output in the developed countries fall and unemployment rise by huge amounts.

Gross Domestic Product (GDP) Aggregate value of goods and services produced within the domestic territory of a country. It includes the replacement investment of the depreciation of capital stock.

Gross fiscal deficit The excess of total government expenditure over revenue receipts and capital receipts that do not create debt.

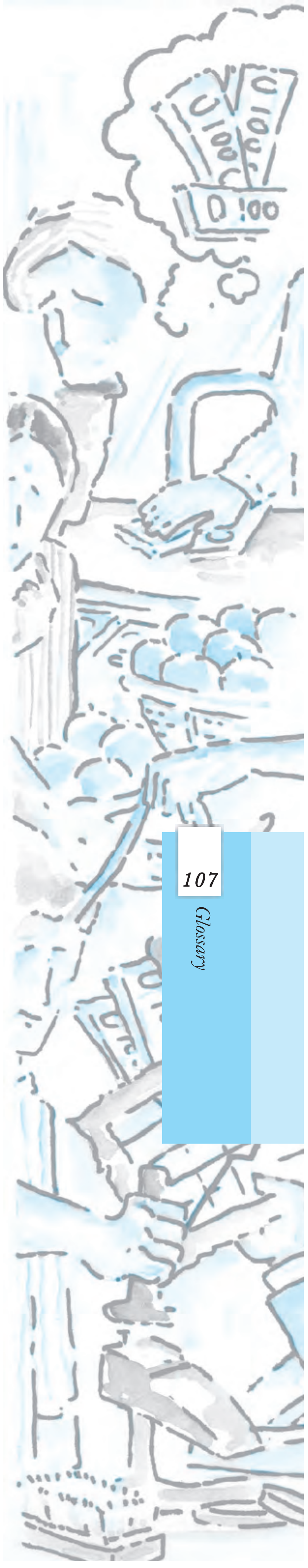
Gross investment Addition to capital stock which also includes replacement for the wear and tear which the capital stock undergoes.

Gross National Product (GNP) GDP + Net Factor Income from Abroad. In other words GNP includes the aggregate income made by all citizens of the country, whereas GDP includes incomes by foreigners within the domestic economy and excludes incomes earned by the citizens in a foreign economy.

Gross primary deficit The fiscal deficit minus interest payments.

High powered money Money injected by the monetary authority in the economy. Consists mainly of currency.

Households The families or individuals who supply factors of production to the firms and which buy the goods and services from the firms.



Imports Purchase of goods and services by the domestic country to the rest of the world.

Income method of calculating national income Method of calculating national income by measuring the aggregate value of final factor payments made (= income) in an economy over a period of time.

Interest Payment for services which are provided by capital.

Intermediate goods Goods which are used up during the process of production of other goods.

Inventories The unsold goods, unused raw materials or semi-finished goods which a firm carries from a year to the next.

John Maynard Keynes (1883 – 1946) Arguably the founder of Macroeconomics as a separate discipline.

Labour Human physical effort used in production.

Land Natural resources used in production – either fixed or consumed.

Legal tender Money issued by the monetary authority or the government which cannot be refused by anyone.

Lender of last resort The function of the monetary authority of a country in which it provides guarantee of solvency to commercial banks in a situation of liquidity crisis or bank runs.

Liquidity trap A situation of very low rate of interest in the economy where every economic agent expects the interest rate to rise in future and consequently bond prices to fall, causing capital loss. Everybody holds her wealth in money and speculative demand for money is infinite.

Macroeconomic model Presenting the simplified version of the functioning of a macroeconomy through either analytical reasoning or mathematical, graphical representation.

Managed floating A system in which the central bank allows the exchange rate to be determined by market forces but intervene at times to influence the rate.

Marginal propensity to consume The ratio of additional consumption to additional income.

Medium of exchange The principal function of money for facilitating commodity exchanges.

Money multiplier The ratio of total money supply to the stock of high powered money in an economy.

Narrow money Currency notes, coins and demand deposits held by the public in commercial banks.

National disposable income Net National Product at market prices + Other Current Transfers from the rest of the World.

Net Domestic Product (NDP) Aggregate value of goods and services produced within the domestic territory of a country which does not include the depreciation of capital stock.

Net interest payments made by households Interest payment made by the households to the firms – interest payments received by the households.

Net investment Addition to capital stock; unlike gross investment, it does not include the replacement for the depletion of capital stock.

Net National Product (NNP) (at market price) GNP – depreciation.

NNP (at factor cost) or National Income (NI) NNP at market price – (Indirect taxes – Subsidies).

Nominal exchange rate The number of units of domestic currency one must give up to get an unit of foreign currency; the price of foreign currency in terms of domestic currency.

Nominal (GDP) GDP evaluated at current market prices.

Non-tax payments Payments made by households to the firms or the government as non-tax obligations such as fines.

Open market operation Purchase or sales of government securities by the central bank from the general public in the bond market in a bid to increase or decrease the money supply in the economy.

Paradox of thrift As people become more thrifty they end up saving less or same as before in aggregate.

Parametric shift Shift of a graph due to a change in the value of a parameter.

Personal Disposable Income (PDI) PI – Personal tax payments – Non-tax payments.

Personal Income (PI) NI – Undistributed profits – Net interest payments made by households – Corporate tax + Transfer payments to the households from the government and firms.

Personal tax payments Taxes which are imposed on individuals, such as income tax.

Planned change in inventories Change in the stock of inventories which has occurred in a planned way.

Present value (of a bond) That amount of money which, if kept today in an interest earning project, would generate the same income as the sum promised by a bond over its lifetime.

Private income Factor income from net domestic product accruing to the private sector + National debt interest + Net factor income from abroad + Current transfers from government + Other net transfers from the rest of the world.

Product method of calculating national income Method of calculating the national income by measuring the aggregate value of production taking place in an economy over a period of time.

Profit Payment for the services which are provided by entrepreneurship.

Public good Goods or services that are collectively consumed; it is not possible to exclude anyone from enjoying their benefits and one person's consumption does not reduce that available to others.

Purchasing power parity A theory of international exchange which holds that the price of similar goods in different countries is the same.

Real exchange rate The relative price of foreign goods in terms of domestic goods.

Real GDP GDP evaluated at a set of constant prices.

Rent Payment for services which are provided by land (natural resources).

Reserve deposit ratio The fraction of their total deposits which commercial banks keep as reserves.

Revaluation A decrease in the exchange rate in a pegged exchange rate system which makes the foreign currency cheaper in terms of the domestic currency.

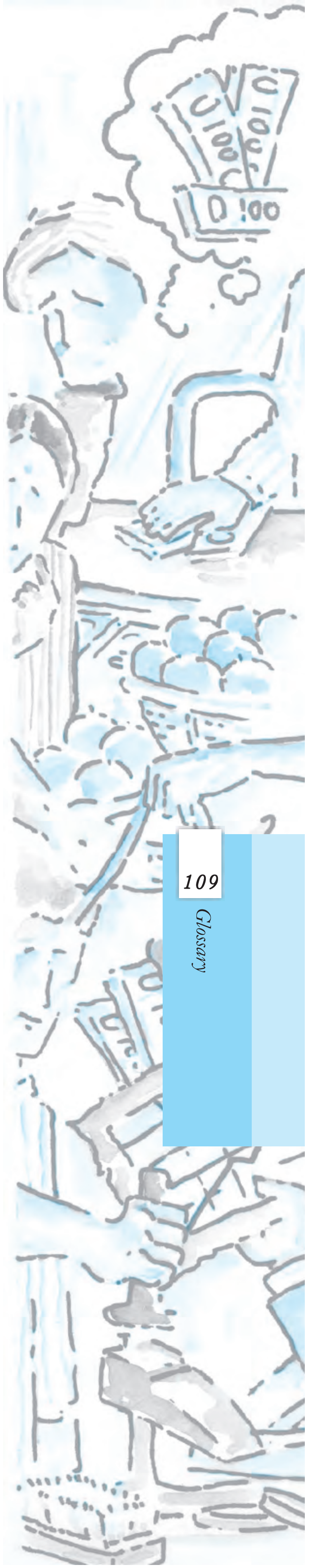
Revenue deficit The excess of revenue expenditure over revenue receipts.

Ricardian equivalence The theory that consumers are forward looking and anticipate that government borrowing today will mean a tax increase in the future to repay the debt, and will adjust consumption accordingly so that it will have the same effect on the economy as a tax increase today.

Speculative demand Demand for money as a store of wealth.

Statutory Liquidity Ratio (SLR) The fraction of their total demand and time deposits which the commercial banks are required by RBI to invest in specified liquid assets.

Sterilisation Intervention by the monetary authority of a country in the money



market to keep the money supply stable against exogenous or sometimes external shocks such as an increase in foreign exchange inflow.

Stocks Those variables which are defined at a point of time.

Store of value Wealth can be stored in the form of money for future use. This function of money is referred to as store of value.

Transaction demand Demand for money for carrying out transactions.

Transfer payments to households from the government and firms Transfer payments are payments which are made without any counterpart of services received by the payer. For examples, gifts, scholarships, pensions.

Undistributed profits That part of profits earned by the private and government owned firms which are not distributed among the factors of production.

Unemployment rate This may be defined as the number of people who were unable to find a job (though they were looking for jobs), as a ratio of total number of people who were looking for jobs.

Unit of account The role of money as a yardstick for measuring and comparing values of different commodities.

Unplanned change in inventories Change in the stock of inventories which has occurred in an unexpected way.

Value added Net contribution made by a firm in the process of production. It is defined as, Value of production – Value of intermediate goods used.

Wage Payment for the services which are rendered by labour.

Wholesale Price Index (WPI) Percentage change in the weighted average price level. We take the prices of a given basket of goods which is traded in bulk.

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