

Study Guide

Fill in the blank

Household Sector

1. If income increase, consumption _____.
2. The _____ suggests that temporary changes in income do not affect consumption.
3. The _____ suggests that consumption responds to changes in lifestyle.
4. Marginal Propensity to Consume equals to _____ divided by _____.
5. The sum of the marginal propensity to consume and the marginal propensity to save equals _____.
6. Gross private saving equals _____ plus _____.
7. Total Consumption equals _____ plus _____ plus _____.
8. Savings finance _____.
9. The paradox of thrift states that as personal savings rates _____, aggregate savings _____.
10. Consumptions goods that last more than three years are _____.
11. Determinants of consumption are _____.
12. Consumption that varies directly with income is called _____.
13. _____ consumption does not vary directly with income.
14. The major categories of consumption expenditures are _____.
15. _____ is the largest category of consumption expenditures.

Business Sector

16. _____ is the major variable affecting investment.
17. Investment that varies with income is called _____.
18. _____ investment does not vary with income.
19. Determinants of investment are _____.
20. Macroeconomically, _____ finances investment.
21. Components of investment are _____.
22. The most volatile component of investment spending is _____.
23. The largest component of investment spending is _____.
24. Structures are divided into _____ and _____ categories.
25. Investment is also known as _____.
26. Gross Private Investment equals _____ plus _____ plus _____.
27. Net Investment equals _____ minus _____.
28. _____ divided by _____ equals the marginal propensity to invest.
29. Marginal product of capital equals _____ divided by _____.
30. Increasing the marginal product of capital _____ demand for capital goods.
31. Demand for capital is a(n) _____.
32. Firms acquire capital assets in order to increase _____.
33. Corporations finance investment primarily out of _____.
34. One of the problems with capital goods is that _____ is relatively fixed in quantity, meaning that fluctuations in demand cause _____ fluctuations in prices.
35. The investment demand curve is a function of _____ and _____.
36. Investment supply comes from _____.
37. The quantity of capital goods eventually decrease from the effects of _____.
38. Depreciation is _____.
39. Output will decrease unless depreciated capital goods are _____.
40. Rapid technological progress creates _____ rates of depreciation.
41. _____ is the generic term for procedures used by firms to establish capital asset needs.
42. _____ compares the present value of future cash inflows with the cost of acquiring an asset.
43. Increasing the discount rate, _____ the value of the capital asset.
44. Calculating PV of cash flows requires projecting _____ and _____.
45. Firms can compare the rates of return on projects against the cost of funding using _____.
46. In the short run, increased investment increases _____.
47. In the long run, _____ is increased by investment.

Government Sector

48. The three economic functions of government are _____.
49. The _____ function is concerned with using government resources to achieve macroeconomic goals.
50. The _____ function is concerned with correcting private market failures.
51. The _____ function is concerned with the distribution of purchasing power.
52. _____ is the use of government taxation and expenditures to achieve macroeconomic goals.
53. Tax divided by income equals _____.
54. Marginal tax rate equals _____ divided by _____.
55. A tax is considered _____ as the marginal tax rate increases as income increases.
56. When the marginal tax rate increases as income _____, the tax is considered progressive.
57. Taxes not affected by income are considered _____.
58. _____ taxes increase when income decreases.
59. The _____ posits that past a certain marginal tax rate, tax revenues will fall.
60. _____ incidence of tax is the measure of who assumes the burden of the tax.
61. A tax is considered _____ if the marginal tax rate increases as income increases.
62. _____ graphs the relationship between tax rates and tax revenues.
63. To generate additional tax revenue from a tax rate cut, _____ would have to increase greatly.
64. _____ suggests that the burden of taxation remain relatively constant across income groups.
65. _____ occurs when individuals with the same income, pay the same tax regardless of the character of the income.
66. _____ are programs that increase aggregate demand during recessions and decrease aggregate demand during inflationary periods without action taken by policymakers.
67. _____ occurs when taxes rise faster than consumption expenditures stopping the economy from reaching full employment.
68. _____ occur as a gap in time between problem recognition and policy action.
69. _____ occurs when public expenditures replace private expenditures.
70. _____ function is concerned with correcting private market failures.
71. Markets with positive externalities tend to _____ goods.
72. Markets with negative externalities tend to _____ goods.
73. For positive externalities, marginal private benefit is _____ than marginal social benefit.
74. For negative externalities, marginal private cost is _____ than marginal social cost.
75. Marginal social cost is the additional _____ accruing to society upon consumption of an additional unit of a product.
76. _____ are where consumers not directly involved in the consumption of an item are affected.
77. _____ is the additional benefit accruing to society upon consumption of an additional unit of a product.
78. _____ and _____ are characteristics of a public good.
79. The characteristic known as _____ for public goods, means that firms are unable to exclude non-paying customers.
80. _____ occurs when additional consumers do not diminish consumption.
81. A _____ is a non-paying customer.
82. Asymmetric information occurs when one buyer has _____ the supplier.
83. _____ exists when agents fail to act in the best interests of the principal.
84. _____ is said to exist when agents pick up bad habits.
85. _____ occurs as only the risky members of the population seek insurance.
86. _____ exists when an agent and principal have different information sets.
87. Social security funding is best characterized as _____.

88. Social security provides _____ benefits.

89. Social Security Trust funds are invested in _____.

90. The Social Security Trust fund contributions _____ as unemployment increases, or economic growth slows down.

91. Distribution focuses on _____.

92. _____ focuses on allocation of resources, goods, and services.

Foreign Sector

93. As foreign incomes rise, demand for domestic _____ and _____ rises.
94. As domestic income rises, demand for foreign _____ and _____ rises.
95. A trade deficit exists when exports are _____ than imports.
96. The current account consists of _____.
97. A current account deficit is financed by a _____.
98. The capital account consists of _____.
99. The ratio of export prices to import prices reflect the _____.
100. _____ says that countries trade in similar but different goods.
101. _____ says that countries trade in goods at which they are the most efficient at producing.
102. Most trade is explained by _____.
103. The principle of _____ says that countries will export the good in which they have the lowest opportunity cost.
104. A currency that is losing value against another currency is experiencing _____.
105. The country experiencing lower inflation than their trading partners will experience a _____ currency.
106. The country experiencing higher interest rates will experience _____ in their currency.
107. Exports benefit from a _____ currency.
108. Imports benefit from a _____ currency.
109. Exports increase demand for the _____ currency.
110. Imports increase demand for the _____ currency.
111. Higher demand for foreign currency will cause a _____ domestic currency.
112. Higher demand for domestic currency will cause a _____ domestic currency.
113. Demand for foreign assets by domestic residents will cause domestic currency to _____.
114. A trade deficit will cause domestic currency to _____.
115. _____ are where exchange rates move in response to changes in the market.
116. _____ are where exchange rates are set by the central bank.
117. _____ says prices are the same everywhere after adjustment for exchange rates.
118. _____ says exchange rates reflect differences in inflation rates.
119. _____ exists when prices are the same worldwide when adjusted by exchange rates.
120. _____ exists when one price prevails for the item when measured in the same currency.
121. Efforts to restrict trade involve creating _____.
122. _____ are a tax on traded goods.
123. _____ are a direct quantitative restriction on imports.
124. Excessive _____ can restrict trade.
125. _____ is selling imported goods below cost.
126. _____ are payments by government to encourage trade.

Solutions

Household Sector

1. increases
2. Permanent Income Hypothesis
3. Life Cycle Hypothesis
4. change in consumption, change in income
5. one
6. Personal Savings, Business Savings
7. services, durable goods, non-durable goods
8. investment
9. increase, decrease
10. durable goods
11. wealth, interest rates, savings
12. induced consumption
13. Autonomous consumption
14. services, durable goods, non-durable goods
15. services

Business Sector

16. Income
17. induced investment
18. Autonomous
19. Capacity, condition, interest rates, technology
20. savings
21. structures, equipment, inventory
22. inventory
23. equipment
24. commercial, residential
25. capital goods
26. structures, equipment, inventory changes
27. Gross Investment, Consumption of Fixed Capital (depreciation)
28. Change in investment, change in income
29. Change in output, change in capital
30. increases
31. derived demand
32. profits
33. retained earnings
34. supply, large
35. income, interest rates
36. savings funds
37. wear, technological obsolescence
38. wear, technological obsolescence
39. replaced
40. higher
41. Capital Budgeting
42. Net Present Value
43. decreases
44. income, interest rates
45. IRR (Internal Rate of Return)
46. aggregate demand
47. aggregate supply

Government Sector

- 48.stabilization, allocation, distribution (SAD) :)
- 49.stabilization
- 50.allocation
- 51.distribution
- 52.Fiscal policy
- 53.average tax rate
- 54.change in tax, change in income
- 55.progressive
- 56.increases
- 57.autonomous
- 58.Regressive.
- 59.Laffer Curve
- 60.Economic
- 61.progressive.
- 62.The Laffer Curve
- 63.labor hours supplied
- 64.Vertical equity
- 65.Horizontal equity
- 66Automatic stablizers
- 67.Fiscal drag
- 68.Lags
- 69.Crowding out
- 70.Allocation
- 71.underproduce
- 72.overproduce
- 73.less than
- 74.less than
- 75.cost
- 76.Externalities
- 77.Marginal social benefit
- 78.Nonrival consumption, nonexclusivity
- 79.nonexclusivity
- 80.Nonrival consumption
- 81.freerider
- 82.different information than
- 83.The agency problem
- 84.Moral hazard
- 85.Adverse selection
- 86.Asymmetric information
- 87.limited pay-as-you-go
- 88.retirement, disability, and survivorship
- 89.US Treasury securities
- 90.decrease
- 91.purchasing power
- 92.Distribution function

Foreign Sector

- 93.goods, currency
- 94.goods, currency
- 95.less than
- 96.exports, imports, investment income, unilateral transfers
- 97.capital account surplus
- 98.purchases or sales of foreign assets, foreign purchases or sales of domestic assets
- 99.terms of trade
- 100.Product differentiation
- 101.Absolute advantage
- 102.product differentiation
- 103.comparative advantage
- 104.depreciation
- 105.appreciating
- 106.appreciation
- 107.depreciating
- 108.appreciating
- 109.domestic
- 110.foreign
- 111.depreciating
- 112.appreciating
- 113.depreciate
- 114.depreciate
- 115.Floating exchange rates
- 116.Fixed exchange rates
- 117.Purchasing Power Parity
- 118.Relative Purchasing Power Parity
- 119.Absolute Purchasing Power Parity
- 120.The Law of One Price
- 121.trade barriers
- 122.Tariffs
- 123.Quotas
- 124.standards
- 125.Dumping
- 126.Export subsidies

True/False

Household Sector

1. The Paradox of Thrift states that investment decreases as savings increase.
2. Non-durable goods are the largest component of consumption.
3. Savings finances investments.
4. The slope of the savings line is the marginal propensity to save.
5. Income is the main influence on consumption.
6. Consumption smoothing means consumption is sacrificed for savings.
7. The Permanent Income Hypothesis states that investment is equal to savings.
8. The Life Cycle Hypothesis suggests that we do not save enough for retirement.
9. Autonomous consumption is influenced by interest rates.
10. Retained earnings are business savings.

Business Sector

11. Demand for capital assets is a derived demand.
12. Supply for capital assets tends to be vertical.
13. Oversupply in the capital assets markets tends to be short lived.
14. Firms need capital assets, such as new stores, to generate income.
15. There can never be too much investment.
16. Firms predominantly use retained earnings to finance investment.
17. Inventory expenditures are the most volatile component of investment spending.
18. Autonomous investment expenditures vary directly with income.
19. The marginal propensity to invest indicates how much new investment will take place for change in the interest rate.
20. Gross Investment minus Consumption of Fixed Capital equals Net Investment.
21. The largest component of investment expenditures is inventory.
22. Interest rates are an important determinant of investment.
23. Technology does not impact investment spending.
24. Tax cuts targeted at the business sector permanently raise demand for capital goods.
25. Demand for capital goods depends on the income generated by that capital and the cost of that capital.
26. The marginal product of capital is the increase in output by an increase in the amount of capital used.
27. Investment supply is not determined by savings.

Government Sector

28. Education exhibits marginal social benefits.
29. Taxation is one means of curbing oversupply in the existence of MSC.
30. Government subsidies cannot overcome undersupply in the existence of MSB.
31. Requiring full disclosure in transactions is one method of overcoming asymmetric information.
32. Offering warranties is one method used to prevent market failure from adverse selection.
33. Bureaucratic failure limits the ability of government to provide solutions.
34. Private health insurance is an example of bureaucratic failure.
35. Monitoring can alleviate the effects of adverse selection.
36. Auditing cannot be of any help in overcoming the agent-principal problem.
37. Statutory tax incidence is the legal assessment of the tax.
38. Tax equity can be evaluated according to the distribution of benefits.
39. Tax equity can be evaluated according to ability to pay.
40. Most sales taxes can be considered progressive.
41. Horizontal equity suggests that people earning the same income should pay the same tax.
42. An efficient tax is one that minimizes welfare loss.
43. Bracket creep occurs when taxpayers are subject to higher tax rates even though real income has not changed.
44. Indexing is increasing tax brackets according to inflation.
45. Fiscal drag occurs when the economy has low tax rates that keep the economy at full employment.
46. Tariffs are not a barrier to trade.
47. A tax credit is a deduction from taxable income.
48. An exemption is a deduction from tax.
49. The standard deduction is in lieu of certain deductible expenses.
50. The largest outlay of the Federal government is for social insurance programs and transfer programs.
51. The Federal government outlays are greater than the aggregate state and local government outlays.
52. Social security is a self-funded program.
53. Unemployment compensation is a "pay as you go" program.
54. Budgeting is the primary tool for managing government operations.
55. Moral hazard exhibited through bad driving records in car insurance can be alleviated by charging higher risk based insurance premiums.
56. Market failure occurs in the case of unemployment insurance due to adverse selection and moral hazard.
57. Government may be able to increase public welfare by providing goods and services in markets that experience market failure.
58. Defined contribution plans specify a fixed amount or percentage contribution into owner directed investment accounts.
59. Defined benefit plans pass the investment risk onto the participant (beneficiary).
60. Social security provides retirement, disability, and survivorship benefits.
61. Social security's retirement benefits are accumulated in an account under a defined contribution type plan.
62. Social security assets are investments in government bonds.
63. Interest earned on investment is not available to pay out benefits.
64. Social security benefits are paid out of the Trust Funds.
65. Government regulation of markets by monitoring and setting of product standards can be

beneficial to both buyer and seller.

66. Government failure does not limit the ability of government to solve private market failures.

Foreign Sector

67. Exchange rates are influenced by both capital and trade flows.
68. Higher interest rates tend to trigger capital inflows thereby strengthening the domestic currency.
69. Strengthening of the domestic currency tends to weaken imports and strengthen exports.
70. Economic growth worsens the trade deficit.
71. Exports are a function of foreign income and domestic prices.
72. Imports are a function of domestic income and domestic prices.
73. Trade barriers tend to increase prices.
74. Import quotas are not a trade barrier.
75. Intensity of competition is lessened with higher trade barriers.
76. International trade generally improves economic welfare.
77. A current account deficit is financed by a capital account surplus.
78. The Balance of Payments measures the stock of funds at a point in time similar to a Balance Sheet.
79. Comparative advantage holds that countries will export goods having the highest opportunity cost to produce.
80. Absolute advantage holds that countries produce goods they can produce efficiently to trade for goods that other countries can more efficiently produce.
81. Tariffs are a tax on international trade.
82. Product differentiation explains a significant amount of the pattern of trade.
83. Absolute Purchasing Power Parity holds that everyone has the same income.
84. Relative Purchasing Power Parity asserts that differences in inflation rates affect exchange rate.
85. Floating exchange rates react to changes in market conditions.
86. Fixed exchange rates are set by the central bank.
87. Economic growth tends to lessen trade deficits.
88. Lowering interest rates causes the currency to appreciate.
89. Higher inflation rates causes the currency to depreciate.

T/F Solutions

Household Sector

1. False, it states that increasing savings rates can decrease aggregate savings.
2. False, services are the largest component of consumption.
3. True
4. True
5. True
6. False, consumption smoothing states that consumption varies less than income.
7. False, people have a concept of an average income they will earn, and spend accordingly.
8. False, there is a pattern of expenditures and income not that one or the other is insufficient.
9. True
10. True

Business Sector

11. True
12. True
13. False, Buildings and equipment can last many years.
14. True
15. False, There can be too many office buildings, malls, etc., as evidenced by high vacancy rates.
16. True
17. True
18. False, induced investment expenditures vary directly with income.
19. False, mpi is the change in investment due to a change in income.
20. True
21. True
22. True
23. False, new products require new capital assets to produce them.
24. False, tax cuts lower the cost of acquiring capital assets but do not increase the consumer demand necessary to justify capital asset expansion.
25. True
26. True
27. False, savings finances investment.

Government Sector

28. True
29. True
30. False, Government subsidies encourage expansion of supply which is desirable when large marginal social benefits are present.
31. True
32. True
33. True
34. False, Bureaucratic failure refers primarily to problems of government administration not private sector.
35. False, Monitoring reveals information about the agent AFTER selection has occurred. It may be of some use in controlling moral hazard.
36. False, Auditing reveals information about the agent, the agent-principal problem is caused by a lack of information.
37. True
38. True
39. True
40. True
41. True
42. True
43. True
44. True
45. False, Fiscal drag occurs when tax rates are too high.
46. False, Tariffs increase prices of imported goods thus causing less to be bought.
47. False, It is a deduction for taxes payable.
48. False, An exemption is a deduction from Gross Income to arrive at taxable income.
49. True
50. True
51. False, State and local governments in the aggregate are larger than the Federal government.
52. True, But currently it has a large unfunded liability.
53. False, It is a self funded program.
54. True
55. True
56. True
57. True
58. True
59. False, Investment risk in defined benefit plans remains with the company, known as the plan sponsor.
60. True
61. False, Social security is a defined benefit type plan although credits are tracked by individual, just as in private defined benefit plans.
62. True
63. False, It is.
64. True
65. True
66. False, government failures imposes costs and prevents government from alleviating private market failure.
67. True

Foreign Sector

- 68. True
- 69. False, appreciating domestic currency increases imports and decreases exports.
- 70. True
- 71. False, exports are a function of foreign income and foreign prices.
- 72. True
- 73. True
- 74. False, quotas restrict trade.
- 75. True
- 76. True
- 77. True
- 78. False, it measures a flow over time.
- 79. NA
- 80. True
- 81. True
- 82. True
- 83. False, absolute PPP only holds the one price prevails.
- 84. True
- 85. True
- 86. True
- 87. False, Economic growth results in more purchases of imported goods thus worsening the trade deficit.
- 88. False, Higher interest rates cause currencies to appreciate.
- 89. True

1. Mary receives a raise of \$10,000 per year. Given a MPC of .9, how much will her savings increase?
2. IBM's profits increase by \$100 million. Given a MPI of .10, how much additional capital assets will be purchased?
3. If total consumption expenditures equal \$100 billion, durable goods are \$30 B, services are \$60 B., then how much is spent on non-durable goods?
4. $GDP = 220$, $C = 100$, $G = 50$, $X = 10$, how much is I ?
5. Exports = \$150 B, Imports = \$100 B, unilateral transfers = -\$50 B, what is the current account surplus (deficit) ?
6. Beta earns \$200,000 and consumes \$30,000 of champagne while Bill earns \$30,000 consuming only \$3,000 of champagne. There is a 10% tax on champagne. Calculate whether the tax is progressive or regressive.
7. Maria and Jack have earned \$80,000 this year. They are entitled to an exemption of \$10,000 after which they must pay 15% tax. What is their average tax rate?
8. What is Maria and Jack's tax liability?
9. Ricardo and Hanna earnings have increased from \$100,000 to \$150,000, subsequently their tax has increased from \$18,000 to \$28,000. What is their marginal tax rate?

10. Marginal Social Cost

Q	MC	MEC	MSC	MB
1	2	0	2	10
2	2	2		8
3	2		6	6
4		6	8	4
5		8	10	2
6		10	12	0

- Fill in the missing blanks.

11. What is the quantity produced by the private market?
12. What would the market produce if external costs were included?
13. What action could the government take to encourage the market to produce the most efficient output?

14. Marginal Social Benefit

Q	MC	MEB	PB	MSB
1	8	1	10	11
2	8	2	8	
3	8	3		9
4		4	4	8
5		5	2	7
6		6	0	6

- Fill in the blanks

15. What is the quantity produced in the private market?
16. What would the market produce if external benefits were included?
17. What action could the government take to encourage the market to produce the most efficient output?
18. Given the following data, which country will trade what goods? The exchange rate is ¥1 per 10

Korean Won, A9;

	Japanese	Koreans
Rice	500	4,000
Silk	5,000	75,000
Paper	1,500	14,000

Let's consider another example of international trade.

	Mexico	Texas
Tequila (liters)	9,000	200
Chili (tons)	300	800
Labor (hours)	300	100

19. Which country enjoys an absolute advantage in tequila?
20. Which country enjoys a comparative advantage in chili?
21. What is the opportunity cost of making chili in Texas?
22. What is the opportunity cost of making tequila in Mexico?

Answers & Solutions

1. \$1,000: $\$10,000 * (1.0 - .9)$
2. \$10 million: $\$100 \text{ million} * .10$
3. \$10 billion: $\$100 - 30 - 60$
4. $\$220 - 50 - 100 - 10 = \60 B
5. $\$150 \text{ B} - \$100 \text{ B} - \$50 \text{ B} = 0$
6. Tax is progressive:

	Income	Consumption	Tax Rate	Tax Liability	Average Tax Rate
Beta	\$200,000	\$30,000	10%	\$3,000	6%
Bill	\$30,000	\$3,000	10%	\$300	1%

7. $\$80,000 - 10,000 = 70,000 * .15 = \$10,500 \text{ tax}$, $\$10,500 \text{ tax} / \$80,000 \text{ income} = 13.1\%$
8. \$10,500
9. $(18,000 - 28,000) / (100,000 - 150,000) = 20\%$

10. Marginal Social Cost

Q	MC	MEC	MSC	MB
1	2	0	2	10
2	2	2	4	8
3	2	4	6	6
4	2	6	8	4
5	2	8	10	2
6	2	10	12	0

- See above

- 11.5 at the quantity where marginal benefit equals marginal cost.
- 12.3 at the quantity where marginal social cost equals marginal benefit.
13. Adding a tax of \$4 per unit or by internalizing external costs by imposing a tort liability.

14. Marginal Social Benefit

Q	MC	MEB	PB	MSB
1	8	1	10	11
2	8	2	8	10
3	8	3	6	9
4	8	4	4	8
5	8	5	2	7
6	8	6	0	6

- See above

- 15.2 at the quantity where marginal cost equals private benefit.
- 16.4 at the quantity where marginal cost equals marginal social benefit.
17. Subsidize production at \$4 per unit.
18. Japanese will buy rice and paper, the Koreans silk. Hint: convert to one currency. In Yen, Koreans pay 400 for rice, 7,500 for silk, 1,400 for paper. It is cheaper for them to buy Japanese silk, sell rice and paper.
19. Mexico; Mexico's absolute advantage $9,000/300 = 3.0$ vs. Texas's $200/100 = 2.0$
20. Texas;

Hours of Labor

Mexico

Texas

Tequila (liters)	.03	.5
Chili (tons)	1.00	.13

21..13 hours or .25 liters tequila

22..03 hours or .03 tons chili

Discussion Questions

1. Asymmetric Information

Identify principal and agent in each of the following situations, and why there is asymmetric information.

Identify if the problem is moral hazard or adverse selection.

What could be done in each of the situations to solve the problem?

1. Lemons for cars
2. Efficiency wages / payment of fixed salary vs. commissions
3. Flood insurance in Florida
4. Students vs Professors - Learning/Reading effort
5. Granting stock options to key managers
6. Requirement of deposits on rentals
7. Public Goods / Externalities

Fuel Cell Buses

Internet infrastructure, links between cities

Military forces

Power Plants

1. Would private market offer this good or service? Why or why not?
8. What externalities are present? How do they affect production in this market?
9. What are remedies available to the government to encourage/discourage production?
10. Cost/Benefit Analysis

Football Stadium

Toll Freeway

New University

1. What are the costs associated with each project?
11. What are the benefits associated with each project?

Discuss problems of valuing external costs and benefits

12. Investment

Computer network

Expansion of restaurant chain

Shopping mall

For the above discuss:

1. Factors that influence demand for these capital assets
13. Factors that influence supply/cost of these capital assets
14. Impact of recession on above investment decisions
15. Consumer Spending
 1. What industries are affected most by a downturn in consumer spending?
16. What factors influence consumer confidence?
17. How does the nation's demographic composition affect savings? consumption? Explain in terms

of life cycle hypothesis.

18. How does employment affect consumer spending?

19. How does a change in tastes affect consumer spending? Say from buying SUV's to buying vans?

20. Foreign Trade

US dollar appreciates

US GDP grows faster than world

For the above discuss:

1. Effects on imports, exports, and balance of payments

21. Other effects such as intensity of competition, price levels, employment, etc.

Selected Definitions

Absolute Advantage

Trade on the basis of which country is the most efficient at production of that good.

Absolute Purchasing Power Parity

Goods have the same price worldwide when measured in the same currency.

Adverse Selection

Only risky members of population seek insurance.

Agency Problem

Agent has different incentives than that of the principal. Examples: stockholders and managers.

Asymmetric Information

Buyer and seller have different information sets. That means one has information that other hasn't.

Autonomous Consumption

Consumption that does not vary with income.

Autonomous Investment

Investment that does not vary with income.

Average Tax Rate

Taxes/Income.

Allocation Function

Effect of Government expenditures on the production of goods and services, particularly to provide services the private market may not provide normally.

Automatic Stabilizers

Programs that do not require policy maker action to begin economic benefits to the economy.

Examples are unemployment compensation, welfare, and a progressive income tax system.

Bracket Creep

Taxpayers move up to higher marginal tax rates due to inflation.

Capital Account

The difference between purchases of foreign assets and sales of domestic assets to foreigners.

Comparative Advantage

Trade on the basis of goods having the lowest opportunity cost within that country with other goods from other countries that have the lowest opportunity cost to those countries.

Consumption of Fixed Capital (Depreciation)

Amount of capital goods that have worn out, been destroyed, or are obsolete in a year.

Consumption Smoothing

The practice of maintaining a relatively even consumption pattern given variations in income.

Co-Payment

The percentage of the claim the insurance company expects policy holders to pay once the deductible has been met (if any deductible is required).

Crowding Out

Public expenditures replacing private expenditures.

Current Account

Exports minus imports plus/minus unilateral transfers.

Deductible

The amount of the claim the insurance company expects the policy holder to pay before reimbursement.

Defined Benefit Plan

A retirement plan where benefits are determined by some formula. Employer must take investment risk and make enough contributions to accumulate enough assets to pay plan benefits

as they are needed.

Defined Contribution Plan

A retirement plan where contributions by employer are fixed or relatively defined by some formula. Benefits are determined by return on investments.

Direct Taxes

Payment of taxes to taxing authority by tax payer. Examples: income taxes, and personal property taxes.

Distribution Function

Effect of government expenditures and taxation on distribution of real income, purchasing power.

Durable Goods

Consumer goods that last longer than one year. Examples: cars, computers, and appliances.

Dumping

Foreign firms are selling products below their cost.

Externalities

Benefits or costs imposed on people not associated with the production or consumption of that good.

Fiscal Drag

The situation where highly progressive income taxes take so much income that aggregate demand never allows the economy to reach full employment.

Fiscal Policy

Using government expenditures and taxation to achieve macroeconomic goals.

Free Rider

A nonpaying customer.

Gross Investment

All new investment expenditures. It may include expenditures used to replace existing equipment and plant.

Horizontal Tax Equity

Those with the same income should have the same tax.

Indirect Taxes

Taxes are paid by someone other than taxpayer as they are included in the price (although they could be listed separately). Examples: sales taxes and business property taxes.

Induced Consumption

Changes in consumption expenditures due to income.

Induced Investment

Changes in investment expenditures due to income.

Laffer Curve

Graphs relationship between tax rates and tax revenue.

Lag

As applied to economic policies, specifically fiscal policy, the time between the time the economic problem occurs and the point that a policy solution takes effect.

Life Cycle Theory

Consumption expenditures follow a typical life pattern.

Marginal External Benefit

Additional benefit imposed on nonparticipants by production or consumption of a good.

Marginal External Cost

Additional cost imposed on nonparticipants by production or consumption of a good.

Marginal Private Benefit

Additional benefit gained by consumption of one more item of a good.

Marginal Private Cost

Additional cost incurred by production of one more item of a good.

Marginal Product of Capital

Change in Output / Change in Capital.

Marginal Propensity to Consume

Change in Consumption / Change in Income.

Marginal Propensity to Invest

Change in Investment / Change in Income.

Marginal Propensity to Save

Change in Savings / Change in Income.

Marginal Social Benefits

Additional external and private benefit caused by production or consumption of a good.

Marginal Social Costs

Additional external and private cost caused by production or consumption of a good.

Marginal Tax Rate

Change in Tax / Change in income.

Moral Hazard

Insured engages in risky behavior.

Paradox of Thrift

Reduction in aggregate savings even while individual savings rates increase.

Permanent Income Hypothesis

Consumption expenditures follow income expectations.

Problem of the Commons

Overutilization of a common resource to the point of depletion.

Product Market

Sum of expenditures in the market for final goods and services by households, businesses, government, and foreigners.

Progressive Tax Rate

Tax rates are higher on higher income taxpayers.

Public Goods

Goods have the characteristics of nonrival consumption and nonexclusivity.

Purchasing Power Parity

Changes in prices of good affect exchange rates.

Quotas

Numerical restriction on imports.

Regressive Tax Rate

Tax rates are higher for lower income taxpayers.

Relative Purchasing Power Parity

Exchange rate changes reflect changes in relative inflation rates.

Stabilization Function

Use of government policies, expenditures, or taxation to achieve macroeconomic goals. This is basically fiscal policy.

Tariff

A tax of imported goods.

Tax Incidence

The redistribution of buying power after taxation.

Trade Balance

Exports minus imports. When imports exceed exports a trade deficit is said to exist.

Vertical Tax Equity

How burdens of taxation are spread among people with different abilities (income levels) to pay.

Z

Symbol for Zorro. :)