

## **GLOSSARY OF TERMS REQUIRED FOR BUSINESS STUDIES AND ECONOMICS**

### **Note to pupils:**

In some cases, it is important for you to have a clear-cut understanding of these terms so that you can reproduce them verbatim in your examination papers. In other cases, you need to understand these terms so that you can appreciate what they mean when they are placed in case studies

### **Absolute advantage**

Absolute advantage occurs when a country or region can create more of a product with the same factor inputs

### **Ad valorem tax**

An indirect tax based on a percentage of the sales price of a good or service. The best known example in the UK is Value Added Tax

### **Ageing population**

An increase in the average age of the population arising from an increase in life expectancy and a fall in the birth rate. In the long run, an ageing population has important implications for both the level and pattern of demand in the economy. There are also widespread consequences for government welfare spending (e.g. on state pensions) and the demand for health and other need services

### **Anti-competitive behaviour**

Anti-competitive practices are strategies operated by firms that are deliberately designed to limit the degree of competition in a market. Such actions can be taken by one firm in isolation or a number of firms engaged in some form of explicit or implicit collusion. Where firms are found to be colluding it would be seen to be against the public interest)

### **Average product**

Total output divided by the total units of labour employed

### **Balance of payments**

The balance of payments (BOP) records all financial transactions between the UK and the Rest of the World. The BOP figures tell us about how much is being spent by British consumers and firms on imported goods and services, and how successful UK firms have been in exporting to other countries and markets.

### **Black market**

A black market (or shadow market) is an illegal market in which the normal market price is higher than a legally imposed price ceiling (or maximum price). Black markets develop where there is excess demand (or a shortage) for a commodity. Some consumers are prepared to pay higher prices in black markets in order to get the goods or services they want. When there is a shortage, higher

prices act as a rationing device. Good examples of black markets include tickets for major sporting events, rock concerts and black markets for children's toys and designer products that are in scarce supply.

## **Brand**

A distinctive product offering which is created by the use of a logo, symbol, name, design, packaging or combination thereof. The key in designing and building a brand is to differentiate it from competitors

## **Brand loyalty**

Brand loyalty exists when consumers regard one particular brand of a product differently from competing products. Persuasive advertising seeks to reinforce and strengthen brand loyalty and thereby make the demand for the product more inelastic. Brand loyalty can be seen as a potential entry barrier in a market. It makes it more difficult and costly for a new product to break into the market when there are established suppliers enjoying a substantial degree of brand loyalty

## **Budget deficit**

When the government is running a budget deficit, it means that in a given year, total government expenditure exceeds total tax revenue. As a result, the government has to borrow through the issue of debt such as Treasury Bills and long-term government bonds.

## **Business cycle**

The business, trade or economic cycle is when actual GDP tends to move up and down in a regular pattern causing booms and slumps (depressions), with recession and recovery as intermediate stages.

## **Capital**

The term capital means investment in goods that are used to produce other goods in the future. Fixed capital includes machinery, plant and equipment, new technology, factories and buildings - all of which are capital goods designed to increase the productive potential of the economy in future years.

## **Capital goods**

Producer or capital goods such as plant (factories) and machinery are useful not in themselves but for the goods and services they can help produce in the future.

## **Capital investment**

This is investment spending by companies on fixed capital goods such as new plant and equipment and buildings. Investment also includes spending on working capital such as stocks of finished goods and work in progress.

## **Capitalist economy**

An economic system organised along capitalist lines uses market-determined prices to guide our choices about the production and distribution of goods; these economies generally have productive resources which are privately owned and managed. State intervention is kept to a minimum. One key role for the state is to maintain the rule of law and protect private property.

## **Ceteris paribus**

Ceteris paribus means all other things being equal. Economists recognise that many factors affect an economic variable. E.g. demand is influenced by the price of the good, income, taste, etc. To simplify and enable analysis, economists isolate the relationship between two variables by assuming ceteris paribus - i.e. that all other influencing factors are held constant

## **Choices**

Because of scarcity, choices have to be made on a daily basis by individual consumers, firms and governments. Making a choice made normally involves a trade-off - in simple terms, choosing more of one thing means giving up something else in exchange. Because wants are unlimited but resources are finite, choice is an unavoidable issue in economics.

## **Comparative advantage**

Comparative advantage exists when a country has lower opportunity cost in the production of a good or service

## **Competitive market**

A competitive market is one where no one firm has a dominant position and where the consumer has plenty of choice when buying goods or services. Firms in a competitive market each have a small market share. There are few barriers to the entry of new firms which allows new businesses to enter the market if they believe they can make sufficient profits

## **Competitive supply**

Goods in competitive supply are alternative products a firm could make with its resources. E.g. a farmer can plant potatoes or carrots. An electronics factory can produce VCRs or DVDs.

## **Corporation tax**

Corporation tax is paid on profits. If the government reduces the rate of corporation tax (or increases investment tax-allowances) there is a greater incentive to invest. Britain has relatively low rates of company taxation compared to other countries inside the EU. This is a factor that helps to explain why Britain has been a favoured venue for inward investment from overseas during the last decade.

## **Complementary goods**

Two complements are said to be in joint demand. Examples include: fish and chips, DVD players and DVDs, iron ore and steel, success and hard work. A rise in the price of a complement to Good X should cause a fall in demand for X. For example an increase in the cost of flights from London Heathrow to New York would cause a decrease in the demand for hotel rooms in New York and

also a fall in the demand for taxi services both in London and New York. A fall in the price of a complement to Good Y should cause an increase in demand for Good Y. For example a reduction in the market price of computers should lead to an increase in the demand for computer peripherals such as printers, scanners and software applications.

### **Composite Demand**

Composite demand exists where goods or services have more than one use so that an increase in the demand for one product leads to a fall in supply of the other. The most commonly quoted example is that of milk which can be used for cheese, yoghurts, cream, butter and other products. If more milk is used for manufacturing cheese, *ceteris paribus* there is less available for butter.

### **Consumption**

Consumption is the use of a good or a service by consumers (households) to satisfy a want or a need

### **Corporate Social Responsibility**

There is growing interest in the concept of ethical businesses and corporate social responsibility where the traditional assumption of businesses driven solely by the profit motive is challenged and where businesses are encouraged to take account of their economic, social and environmental impacts.

### **Cost benefit analysis**

Governments face choices: do we build new hospitals or new or new schools, etc. Given limited resources how can government decide which projects to prioritize and build and which to reject? Cost Benefit Analysis (CBA) offers a systematic framework for measuring and evaluating the likely impact of public sector project, takes into account both private and external costs and benefits over the entire life of the project.

### **Costs**

Costs are those expenses faced by a business when producing a good or service for a market. Every business faces costs - these must be recouped if a business is to make a profit from its activities. In the short run a firm will have fixed and variable costs of production

### **Demand**

Demand is defined as the quantity of a good or service that consumers are willing and able to buy at a given price in a given time period. Each of us has an individual demand for particular goods and services.

### **Demand curve**

A demand curve shows the relationship between the price of an item and the quantity demanded over a period of time. For normal goods, more of a product will be demanded as the price falls. This is because at lower prices, consumers can afford to purchase more with their income. A fall in prices causes an increase in a consumers' real income. Secondly, a fall in price makes one good

relatively cheaper than a substitute encouraging consumers to switch their demand in favour of the lower priced product.

### **De-merit goods**

Merit goods are 'good' for you. In contrast, de-merit goods are thought to be 'bad' for you. Examples include alcohol, cigarettes and various drugs. The consumption of de-merit goods can lead to negative externalities which causes a fall in social welfare. The government normally seeks to reduce consumption of de-merit goods. Consumers may be unaware of the negative externalities that these goods create - they have imperfect information.

### **Diminishing returns**

The Law of Diminishing Returns occurs because factors of production are not perfect substitutes for each other. Resources used in producing one type of product are not necessarily as efficient when switched to the production of another good or service. The law of diminishing returns lies at the heart of conventional production and cost theory.

### **Direct taxation**

Direct taxation is levied on income, wealth and profit. Direct taxes include income tax, national insurance contributions, capital gains tax, and corporation tax.

### **Diseconomies of scale**

There are nearly always limits to the potential to achieve economies of scale. Indeed when a business expands beyond a certain size, average costs per unit may start to increase. This is known as diseconomies of scale. Diseconomies of scale arise mainly through problems of management. As a firm grows, management finds it more difficult to organize production efficiently. It is much easier to lose control of costs in a large organization than in a small business.

### **Division of Labour**

Division of labour means the specialization of the functions and roles involved in making the separate parts of a product. It is closely tied to the standardization of production, the introduction and perfection of machinery, and the development of large-scale industry. As a result of mass-production techniques, total production is many times what it would be had each worker made the complete product. Problems created by the division of labour include job monotony, technological unemployment, and eventually chronic unemployment if the economy does not expand quickly enough to reabsorb the displaced labour.

### **Economies of scale**

Economies of scale are of huge importance to many businesses - not least those that have to compete in international markets where cost competitiveness is vital. Both producers and consumers stand to gain from economies of scale. Businesses can bring down their average costs by producing on a larger scale. This opens up the possibility of them making bigger profit margins and also building a competitive advantage in their chosen markets. For consumers, lower costs per unit can be translated into a reduction in market prices which leads to a rise in their real purchasing power and a potential improvement in economic welfare (e.g. measured by the level of consumer surplus).

## **Economic growth**

Economic growth is best defined as a long-term expansion of the productive potential of the economy. Sustained growth should lead higher real living standards and rising employment. Short term growth is measured by the annual % change in real national output (real GDP).

## **Effective demand**

Demand in economics must be effective. Only when a consumers' desire to buy a product is backed up by an ability to pay for it do we speak of demand. For example, many people would be willing to buy a luxury sports car, but their demand would not be effective if they did not have the financial means to do so. They must have sufficient real purchasing power.

## **Entrepreneur**

An entrepreneur is an individual who seeks to supply products to a market for a rate of return (i.e. a profit). Entrepreneurs will usually invest their own financial capital in a business and take on the risks associated with a business investment. The reward to this risk-taking is the profit made from running the business. Many economists agree that entrepreneurs should be classed as specialised part of the factor input 'labour'.

## **External costs**

External costs are those costs faced by a third party for which no appropriate compensation is forthcoming. Identifying and then estimating a monetary value for air pollution is a difficult exercise - but one that is increasingly important for economists concerned with the impact of economic activity on our environment.

## **External economies of scale**

External economies arise from the growing size of an industry. As the industry grows in size and there are more firms in the industry, these companies may enjoy lower average total costs for several reasons: Firms will be able to draw on a pool of skilled labour, trained by firms and government, thus reducing their own training and living costs.

## **Externalities**

Externalities are third party effects arising from production and consumption of goods and services for which no appropriate compensation is paid. Externalities occur in nearly every market and industry and can cause market failure if the price mechanism does not take into account the full social costs and benefits of production and consumption. Externalities occur outside of the market i.e. they affect economic agents not directly involved in the production and/or consumption of a particular good or service

## **Factor immobility**

Factor immobility occurs when a factor is unable to switch easily between different sectors of the economy

## **Finite resources**

There are only a finite number of workers, machines, acres of land and reserves of oil and other natural resources on the earth. Because resources are finite, we cannot produce an infinite number of goods and services. By producing more for an ever-increasing population, we are in danger of destroying the natural resources of the planet. This will have serious consequences for the long-term sustainability of economies throughout the world and potentially enormous implications for our living standards and the quality of life.

## **Firm**

A firm is an organisation that uses factors of production (resources) to create goods and services  
e.g. public limited companies plcs

## **Fiscal policy**

Fiscal policy involves the use of government spending, taxation and borrowing to influence both the pattern of economic activity and also the level and growth of aggregate demand, output and employment. It is important to realise that changes in fiscal policy affect both aggregate demand (AD) and aggregate supply (AS).

## **Fixed costs**

These costs relate to the fixed factors of production and do not vary directly with the level of output. Examples of fixed costs include: rent and business rates, the depreciation in the value of capital equipment (plant and machinery) due to age and marketing and advertising costs

## **Free goods**

Not all goods have an opportunity cost. Free goods are not scarce and no cost is involved when consuming them

## **Free Market Economy**

In a free market economic system, governments take the view that markets work, assume a laissez faire (let alone) approach, step back, and allow the forces of supply and demand to set prices and allocate resources. Government intervention is required mainly to prevent or correct market failure through for example enforcing anti-monopoly legislation (i.e. preventing abuses of market power), enforcing private property rights, and redistributing income through the tax and benefit system etc

## **Free trade**

Free trade exists when there are few barriers to international trade between countries. This allows resources to be allocated without the intervention of import tariffs, quotas, and other forms of import controls. Free trade based on comparative advantage can under certain conditions lead to a rise in economic welfare. Countries can specialise in the production of goods and services in which they have a comparative advantage (lower opportunity cost)

## **Frictional unemployment**

This type of unemployment reflects job turnover in the labour market. Even when there are vacancies it takes time to search and find new employment and workers will remain frictionally

unemployed. Improving the flow of information in the labour market is one way of reducing the scale of frictional unemployment.

### **Geographical immobility**

People may also experience geographical immobility – meaning that there are barriers to them moving from one area to another to find work

### **Globalisation**

Globalisation is the increased worldwide integration and interdependence of those economies that trade. For example, transnational firms locate the production and assembly of goods in different locations across the world.

### **Government failure**

Even with good intentions governments seldom get their policy application correct. They can tax, control and regulate but the eventual outcome may be a deepening of the market failure or even worse a new failure may arise. Government failure may range from the trivial, when intervention is merely ineffective, but where harm is restricted to the cost of resources used up and wasted by the intervention, to cases where intervention produces new and more serious problems that did not exist before. The consequences of this can take many years to reverse.

### **Gross domestic product**

Gross Domestic Product (GDP) measures the value of output produced within the domestic boundaries of the UK over a given time period. GDP includes the output of the many foreign owned firms that are located in the UK following the high levels of foreign direct investment in the UK economy over many years.

### **Gross national product**

Gross National Product (GNP) measures the final value of output or expenditure by UK owned factors of production whether they are located in the UK or overseas.

### **Horizontal integration**

Where two firms join at the same stage of production in one industry. For example two car manufacturers may decide to merge, or a leading bank successfully takes-over another bank. The world's biggest contested takeover took place in 2000 when British business Vodafone mounted a successful bid for German telecoms firm Mannesmann

### **Human capital**

Human capital is the stock of skills, experience and qualifications held by the labour force that can be brought into the production function. New Growth theorists believe there is a strong link between investment in human capital and long-term growth.

### **Human resource management**

HRM describes improvements to procedures involving recruitment, training, promotion, retention and support of faculty and staff. This becomes critical to a business when the skilled workers it

needs are in short supply. Recruitment and retention of the most productive and effective employees makes a sizeable difference to corporate performance in the long run (as does the flexibility to fire those at the opposite extreme!)

### **Import quota**

A quota is a physical limit imposed upon the amount of a good that can be imported

### **Income**

Income represents a flow of earnings from using factors of production to generate an output of goods and services

### **Indirect tax**

An indirect tax is imposed on producers (suppliers) by the government. Examples include excise duties on cigarettes, alcohol and fuel and also value added tax. Taxes are levied by the government for a number of reasons - among them as part of a strategy to curb pollution and improve the environment. A tax increases the costs of a business causing an inward shift in the supply curve. The vertical distance between the pre-tax and the post-tax supply curve shows the tax per unit. With an indirect tax, the supplier may be able to pass on some or all of this tax onto the consumer through a higher price. This is known as shifting the burden of the tax and the ability of businesses to do this depends on the price elasticity of demand and supply.

### **Inferior goods**

For normal products, more is demanded as income rises, and less as income falls. Most products are like this but there are exceptions called inferior products. They are often cheaper poorer quality substitutes for some other good. Examples include black-and-white television sets, cigarettes, white bread and several other basic foods. With a higher income a consumer can switch from the cheaper substitute to the more expensive, but preferred alternative. As a result, less of the inferior product is demanded at higher levels of income. Inferior goods have a negative income elasticity of demand.

### **Inflation**

Inflation is a sustained rise in the general price level over time. The rate of inflation is the percentage change in a given price index over the last twelve months

### **Internal expansion**

Firms can generate higher sales and increased market share by expanding their operations and exploiting possible economies of scale. The alternative is to grow externally through mergers and takeovers. See also integration of firms

### **Joint Supply**

Joint supply describes a situation where an increase or decrease in the supply of one good leads to an increase or decrease in supply of another. For example an expansion in the volume of beef production will lead to a rising market supply of beef hides. A contraction in supply of lamb will reduce the supply of wool

### **Knowledge-based industries**

Knowledge based industries are essentially service industries. Examples include communication, finance, and personal services. However hi-tech manufacturing also comes under this umbrella term. This would include pharmaceuticals, computer hardware and software industries and TV and other communication equipment.

## **Land**

Land is the natural resources available for production. Some nations are endowed with natural resources and specialise in the extraction and production of these resources – for example – the development of the North Sea Oil and Gas in Britain and Norway.

## **Law of demand**

The law of demand is that there is an inverse relationship between the price of a good and demand. As prices fall we see an expansion of demand. If price rises there should be a contraction of demand.

## **Long run**

The long run in economics is defined as a period of time in which all factor inputs can be changed. The firm can therefore alter the scale of production. If as a result of such an expansion, the firm experiences a fall in long run average total cost, it is experiencing economies of scale. Conversely, if average total cost rises as the firm expands, diseconomies of scale are happening.

## **Managerial economies**

A large manufacturer can employ specialist staff to supervise production, thus cutting managerial costs per unit. Greater control of the workforce should raise labour productivity. Specialist administrative equipment, like networked systems of computers, can be used profitably in large firms. The cost of transmitting business information is reduced and employees can communicate more effectively.

## **Marginal cost**

Marginal cost is defined as the change in total costs resulting from increasing output by one unit. Marginal costs relate to variable costs only. Changes in fixed costs in the short run affect total costs, but not marginal costs.

## **Marginal product**

Marginal product (MP) = the change in total output from adding one extra unit of labour

## **Market demand**

Market demand is the sum of the individual demand for a product from each consumer in the market. If more people enter the market, then demand at each price level will rise. For example, market demand for mobile phones has expanded rapidly over the last few years as call costs have fallen. Eventually though the market demand for mobile phones will reach saturation point - every product has a life-cycle.

## **Market dominance**

Market dominance occurs when a firm acquires monopoly power

### **Market equilibrium**

Equilibrium means a state of equality between demand and supply. Without a shift in demand and/or supply there will be no change in market price. Prices where demand and supply are out of balance are termed points of disequilibrium. Changes in the conditions of demand or supply will shift the demand or supply curves. This will cause changes in the equilibrium price and quantity in the market.

### **Market failure**

Market failure occurs when freely functioning markets, operating without government intervention, fail to deliver an efficient or optimal allocation of resources - Therefore - economic and social welfare may not be maximised - leading to a loss of allocative and productive efficiency. When this happens there is market failure - In reality - all markets fail at some time or other. Market failure exists when the competitive outcome of markets is not efficient from the point of view of the economy as a whole. This is usually because the benefits that the market confers on individuals or firms carrying out a particular activity diverge from the benefits to society as a whole

### **Market supply**

Market supply is the total amount of an item producers are willing and able to sell at different prices, over a given period of time e.g. one month. In an industry, a market supply curve is the horizontal summation of all each individual firm's supply curves

### **Marketing economies**

A large-scale manufacturer can buy raw materials and other inputs (components) in bulk and thereby negotiate lower prices than the small manufacturer. When a major buyer in a market has substantial buying power, this is termed a monopsony. For example, the major hotel chains can buy the consumables used in hotel rooms at much lower cost than individual consumers. The motor industry can use its monopsony power when negotiating the supply of tyres, in-car entertainment systems and other component parts. The average cost of selling each unit produced can also be lower, because advertising and marketing costs can be spread over a large output sold and specialist salesmen/buyers are employed to maximise sales.

### **Maximum price**

The Government can set a legally imposed maximum price in a market that suppliers cannot exceed - in an attempt to prevent the market price from rising above a certain level. To be effective a maximum price has to be set below the free market price. One example of a maximum price might be for foodstuffs when a shortage of essential foodstuffs threatens a very large rise in the free market price. Other examples include rent controls on properties - for example the complex system of rent controls still in place in Manhattan in the United States.

## **Mergers**

Mergers take place when two businesses agree to merge their operations and become one single company. There are different types of integration between firms - see also horizontal and vertical integration

## **Merit goods**

Merit Goods are those goods and services that the government feels that people will under-consume, and which ought to be subsidised or provided free at the point of use. Both the public and private sector provide merit goods & services. Consumption of merit goods is widely believed to generate positive externality effects - where the social benefit from consumption exceeds the private benefit. A merit good is a product that society values and judges that everyone should have regardless of whether an individual wants them. In this sense, the government (or state) is acting paternally in providing merit goods and services. They believe that individuals may not act in their own best interests in part because of imperfect information about the benefits that can be derived.

## **Minimum price**

A minimum price is a legally imposed price floor below which the normal market price cannot fall. To be effective the minimum price has to be set above the normal equilibrium price. A good example of this is minimum wage legislation currently in force in the UK. The National Minimum Wage was introduced by the Labour Government in April 1999. The main adult rate for the minimum wage in the UK is £4.80 per hour.

## **Mixed economy**

The price mechanism is the only allocative mechanism solving the economic problem in a free market economy. However, most modern economies are mixed economies, comprising not only a market sector, but also a non-market sector, where the government uses the planning mechanism to provide goods and services such as police, roads and health.

## **Monopoly**

A pure monopolist is a single seller of a product in a given market or industry. In simple terms this means the firm has a market share of 100%. The working definition of a monopolistic market relates to any firm with greater than 25% of the industries' total sales. Monopolies can develop in a variety of ways:

## **Natural monopoly**

A natural monopoly exists when there is great scope for economies of scale to be exploited over a very large range of output. Indeed the scale of production that achieves productive efficiency may be a high percentage of the total market demand for the product. Natural monopolies are associated with industries where there is a high ratio of fixed to variable costs. For example, the fixed costs of establishing a national distribution network for a product might be enormous, but the marginal (variable) cost of supplying extra units of output may be very small. In this case, the average total cost will continue to decline as the scale of production increase, because fixed (or overhead) costs are being spread over higher and higher levels of output.

## **Needs and wants**

Humans have many different types of wants and needs e.g.: economic, social and psychological. In economics the focus is on studying how material wants and needs are satisfied: A need is something essential for survival e.g. food satisfies hungry people. A want is something desirable but not essential to survival e.g. cola quenches thirst. Household (consumer) wants and needs are satisfied (met) by consuming (using) products i.e. goods or services

## **Negative externalities**

Negative externalities occur when production and/or consumption impose external costs on third parties outside of the market for which no appropriate compensation is paid

## **Normal goods**

Normal goods have a positive income elasticity of demand so as consumers' income rises, so more is demanded at each price level. Normal necessities have an income elasticity of demand of between 0 and +1. Normal luxuries have an income elasticity of demand  $> +1$  i.e. the demand rises more than proportionate to a change in income

## **Occupational immobility**

Occupational immobility occurs when there are barriers to the mobility of factors of production between different sectors of the economy which leads to these factors remaining unemployed, or being used in ways that are not economically efficient. Some capital inputs are occupationally mobile – a computer can be put to use in many different industries. Commercial buildings can be altered to provide a base for many businesses. However some units of capital are specific to the industry they have been designed for. Labour often experiences occupational immobility. For example, workers made redundant in the sheet metal industry or in heavy engineering may find it difficult to gain re-employment in the near term. They may have job-specific skills that are not necessarily needed in growing industries. This implies that there is a mismatch between the skills on offer from the unemployed and those required by employers looking for extra workers. This is also called structural unemployment and explains why there is a core of workers in the UK who find it difficult to find paid work. Clearly this leads to a waste of scarce resources and represents market failure.

## **Opportunity cost**

There is a well known saying in economics that "there is no such thing as a free lunch". Even if we are not asked to pay a price for consuming a good or a service, economic resources are used up in the production of it and there must be an opportunity cost involved - i.e. the next best alternative that might have been produced using those resources. Opportunity cost measures the cost of any choice in terms of the next best alternative foregone.

## **Patents**

Patents are government enforced property rights to prevent the entry of rivals. They are generally valid for 17-20 years and give the owner an exclusive right to prevent others from using patented products, inventions, or processes

## **Pollution taxes**

One common approach to adjust for externalities is to tax those who create negative externalities. This is sometimes known as “making the polluter pay”. Introducing a tax increases the private cost of consumption or production and ought to reduce demand and output for the good that is creating the externality. Taxes send a signal to polluters that our environment is valuable and is worth protecting.

## **Positive externalities**

Positive externalities exist when third parties benefit from the spill-over effects of production/consumption e.g. the social returns from investment in education & training or the positive benefits from health care and medical research

## **Predatory pricing**

Firms may adopt predatory pricing policies by lowering prices to a level that would force any new entrants to operate at a loss. A high profile case came to a head in 1999 when the Office of Fair Trading found News International guilty of adopting predatory pricing policies in a bid to reduce competition in the market for broadsheet newspapers.

## **Price elasticity of demand**

Price elasticity of demand measures the responsiveness of demand for a product following a change in its own price. The formula for calculating the co-efficient of elasticity of demand is: Percentage change in quantity demanded divided by percentage change in price. If the demand increased by 10% due to a fall in a good's own price of 5%, the price elasticity of demand for a product would be 2. Since changes in price and quantity nearly always move in opposite directions, economists usually do not bother to put in the minus sign. We are more concerned with the co-efficient of price elasticity of demand.

## **Price elasticity of supply**

Price elasticity of supply (Pes) measures the relationship between change in quantity supplied and a change in price. When supply is elastic, producers can increase production without a rise in cost or a time delay. When supply is inelastic, firms find it hard to change their production levels in a given time period. The formula for price elasticity of supply is: Percentage change in quantity supplied divided by the Percentage change in price

## **Price mechanism**

The price mechanism is the means by which decisions of consumers and businesses interact to determine the allocation of resources between different goods and services.

## **Primary Sector**

This involves extraction of natural resources e.g. agriculture, forestry, fishing, quarrying, and mining

## **Privatisation**

Over the last twenty-five years, many former state-owned businesses have been privatised – i.e. they have transferred from the public sector into the private sector. Examples in Britain include British Gas, British Telecom, British Airways, British Steel, British Aerospace, the regional water companies, the main electricity generators and distributors, and the Railways. British Rail was privatised in 1994 but the failure of Railtrack led to the creation of Network Rail, a ‘not for profit’ company in 2002. The Labour Government has continued to privatise or part-privatise other parts of the UK public sector since it came to power in 1997. Privatization is designed to break up state monopolies and create more competition. The government also created utility regulators who have imposed price controls on many of these industries and who are now over-seeing the move towards competitive markets in areas such as gas and electricity supply and telecommunications.

### **Producer subsidy**

Subsidies represent payments by the government to suppliers that have the effect of reducing their costs and encouraging them to increase output. The effect of a subsidy is to increase supply and therefore reduce the market equilibrium price. The subsidy causes the firm's supply curve to shift to the right. The total amount spent on the subsidy is equal to the subsidy per unit multiplied by total output.

### **Production**

Production involves in nearly all cases, using up scarce resources. Production can take place at various levels - ranging from primary industries in which basic resources are extracted through manufacturing and construction (secondary industries) to tertiary and quaternary industries (the service sector).

### **Production**

Production refers to the output of goods and services produced within a market in a given time period

### **Productivity**

When economists and government ministers talk about productivity they are referring to how productive labour is. But productivity is also about other inputs into production. So, for example, a company could increase productivity by investing in new capital machinery which embodies the latest technological progress, and which reduces the number of workers required to produce the same amount of output.

### **Profits**

Profits are made when total revenue exceeds total cost.  $\text{Total profit} = \text{total revenue} - \text{total cost}$ .  $\text{Profit per unit supplied} = \text{price} - \text{average total cost}$ . The standard assumption is that private sector businesses seek to make the highest profit possible from operating in a market. There are times when this assumption can be dropped - but the profit seeking firm or business remains a powerful component of standard economic analysis.

### **Progressive taxation**

With a progressive tax, the marginal rate of tax rises as income rises. I.e. as people earn more income, the rate of tax on each extra pound earned goes up. This causes a rise in the average rate of tax (the percentage of income paid in tax).

### **Proportional taxation**

With a proportional tax, the marginal rate of tax is constant. For example, we might have an income tax system that applied a standard rate of tax of 25% across all income levels. If the marginal rate of tax is constant, the average rate of tax will also be constant.

### **Public goods**

The characteristics of pure public goods are the opposite of private goods: Non-excludability: The benefits of public goods cannot be confined to only those who have paid for it. In this sense, non-payers can enjoy the benefits of consumption for no financial cost. Non-rivalry in consumption: Consumption of a public good by one person does not reduce the availability of a good to others - we all consume the same amount of public goods even though our tastes for these goods (and therefore our valuation of the benefit we derive from them) might differ

### **Quaternary Sector**

The quaternary sector is involved with information processing e.g. education, research and development, administration, and financial services such as accountancy

### **Resource allocation**

Resource allocation refers to a given use of land, labour, capital and entrepreneurs those results in particular amounts of goods and services being produced. A reallocation of resources means some factors of production are switched from one use to another i.e. into different industries and occupations resulting in different amounts of goods and services produced.

### **Revenue**

Revenue means the income firms receive from the sale of output

### **Regressive taxation**

With a regressive tax, the rate of tax falls as incomes rise – I.e. the average rate of tax is lower for people of higher incomes. In the UK, most examples of regressive taxes come from excise duties of items of spending such as cigarettes and alcohol. There is well-documented evidence that the heavy excise duty applied on tobacco has quite a regressive impact on the distribution of income in the UK.

### **Risk-bearing economies**

A large firm sells in more markets and has a wider product range than a smaller company. The rapid expansion of multi product businesses is part of a process of diversification. This helps spread business risks so that if one market does badly the company has other markets to sell into.

### **Scarcity**

Scarce means limited. Our resources of land labour capital and enterprise are finite. There is only a limited amount of resources available to produce the unlimited amount of goods and services we desire

### **Seasonal unemployment**

This is a kind of unemployment which occurs regularly because of seasonal changes in the demand for certain kinds of labour. Good examples include construction, hotels and leisure and agriculture. See also structural unemployment and real wage unemployment as alternative explanations for unemployment

### **Secondary Sector**

This involves the production of goods in the economy, i.e. transforming materials produced by the primary sector e.g. energy manufacturing and the construction industry

### **Short run**

The short run is a period of time when there is at least one fixed factor of production. This is usually the capital input such as plant and machinery and the stock of building and technology. In the short run, output expands when more variable factors (labour, raw materials and components) are employed.

### **Stakeholder conflict**

Stakeholder conflict occurs when different stakeholders have different objectives. Firms have to choose between maximising one objective or satisfactorily meeting several stakeholder objectives, so called satisficing

### **Stakeholders**

Stakeholders are groups who have an interest in the activity of a business e.g. shareholders, managers, employees, suppliers, customers, government and local communities. Different stakeholders have different objectives e.g. owners want maximum profits, customers low prices and workers high wages. Stakeholder conflict ensues. In plcs ownership and control are separate.

**Owners seek profits; managers may seek sales maximisation as these increase bonuses.**

### **Structural unemployment**

This type of unemployment exists even when there are job vacancies, due to a mismatch between the skills of the registered unemployed and those required by employers. People made redundant in one sector of the economy cannot immediately take up jobs in other sectors

### **Substitute goods**

Substitutes are goods in competitive demand and act as replacements for another product. For example, a rise in the price of Esso petrol (other factors held constant) should cause a substitution effect away from Esso towards competing brands. A fall in the monthly rental charges of cable companies or Vodafone mobile phones might cause a decrease in the demand for British Telecom services. Consumers will tend over time to switch to the cheaper brand or service provider. When it is easy to switch, consumer demand will be sensitive to price changes (see the section on price elasticity of demand)

## **Substitute in production**

A substitute in production is a product that could have been produced using the same resources. Take the example of barley. An increase in the price of wheat makes wheat growing more attractive. The pursuit of the profit motive may cause farmers to use land to grow wheat rather than barley.

## **Sustainable development**

Sustainable development means not using up resources faster than the Earth can replenish them. "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." Brundtland Report and also involves the elimination of poverty in ways that do not damage the environment for future generations.

## **Supply**

Supply is the quantity of a good or service that a producer is willing and able to supply onto the market at a given price in a given time period. The basic law of supply is that as the market price of a commodity rises, so producers expand their supply onto the market.

## **Supply curve**

A supply curve shows a relationship between price and quantity a firm is willing and able to sell. If the price of the good varies, we move along a supply curve. A price rise will usually cause an expansion of supply. If the market price falls there would be a contraction of supply in the market. Producers are responding to price signals when making their output decisions.

## **Tariff**

A tariff is a tax on the value of imports and remains the most common form of trade protection in the world economy today despite numerous attempts by the World Trade Organization (WTO) to encourage a reduction in average tariff levels between countries.

## **Tertiary Sector**

The tertiary sector provided services such as banking, finance, insurance, retail, education and travel and tourism

## **Total Revenue**

Total Revenue (TR) refers to the amount of money received by a firm from selling a given level of output and is found by multiplying price (P) by output i.e. number of units sold (TR)

## **Trade**

Trade is the exchange of goods or services. Trade improves consumer choice and total welfare. Individual have different skills. Regions or countries have different factor endowments e.g. climate, skilled labour force, and natural resources vary between nations. Therefore individuals, regions and countries are better placed in the production of certain goods than others

## **Value of money**

The value of money refers to the amount of goods and services £1 can buy and is inversely proportionate to the rate of inflation. Inflation reduces the value of money. When prices rise, the value of money falls.

### **Variable costs**

Variable costs vary directly with output. I.e. as production rises, a firm will face higher total variable costs because it needs to purchase extra resources to achieve an expansion of supply. Common examples of variable costs for a business include the costs of raw materials, labour costs and consumables.

### **Vertical integration**

Where a firm develops market dominance by integrating with different stages of production in the industry e.g. by buying its suppliers or controlling the main retail outlets. A good example is the oil industry where many of the leading companies are both producers and refiners of crude oil. Forward vertical integration occurs when a business merges with another business further forward in the supply chain. Backward vertical integration occurs when a firm merges with another business at a previous stage of the supply chain

### **Wealth**

Wealth is a stock of assets that generates a flow of income and can be held in a variety of forms by individuals, firms and also the nation as a whole.

### **Working Capital**

Working capital refers to stocks of finished and semi-finished goods (or components) that will be either consumed in the near or will be made into finished consumer goods. Another term for stocks is inventories.