UNIT 1 THE MICRO-ECONOMIC ENVIRONMENT OF BUSINESS

1.1 Getting started

Economists have two ways of looking at economics and the economy. One is the macro approach, and the other is the micro approach. Macroeconomics is the study of the economy as a whole; microeconomics is the study of individual consumers and the business firm. The first seeks solutions to macro-economic problems such as how employment can be increased, and what can be done to increase the output of goods and services. The latter examines cause-and-effect relationships that influence choices of individuals, business firms and society.

Discuss the following points.

1. Microeconomics vs. Macroeconomics.
2. Which approach is the better of the two mentioned above to answer the economic questions given below?

- How fast the economy is running?
- How much overall output is being generated?
- How does scarcity influence choices of individuals, business firms and society?
- How do prices relate to different units in the economy?
- How much is total income?

1.2 Look through the following vocabulary notes which will help you understand the text and discuss the topic.

an approach	научный подход
to seek to do smth to seek solutions	стремиться сделать что-либо искать выход, решение
versus, vs.	по сравнению с чем-либо
input, factor inputs ant. output output per capita	исходные данные, затраченные ресурсы выходные данные, готовая продукция (антоним) продукция на душу населения
to influence smth, syn. to affect influence, syn. effect	влиять на что-либо влияние
income, ant. spending,	доход, (антоним) расход(ы)

expenditure	
essential essentials	основной, существенный основы
to operate	работать, производить операции, приводить в действие
to subject to be subject to smth	подвергать подвергаться чему-либо
movements, syn. changes	изменения
fiscal policy	фискальная (налоговая) политика
monetary policy	монетарная (денежная) политика
legislation	законодательство
to distribute distribution redistribution	распределять распределение, перераспределение
an activity, activities	деятельность
public the general public	государственный широкая общественность
to vary various variable a variable variety	различаться различный, разнообразный переменный переменная разнообразие
economic growth	экономический рост
an interest rate	процентная ставка
taxation a tax to tax to levy, to impose a tax corporation tax value added tax inheritance tax capital gains tax excise duties	налогообложение налог облагать налогом взимать, устанавливать налог налог на прибыль налог на добавленную стоимость налог на наследство налог на прирост капитала акцизные пошлины
households	домохозяйства

to flow a flow	двигаться, течь движение, поток
labor	труд рабочих
enterprise an enterprise	предпринимательство предприятие
a leakage, ant. an injection	утечка, (ант.) вливание
to import imports ant. to export exports	импортировать импортируемые товары (ант.) экспортировать экспортируемые товары
savings	сбережения
a surplus	излишек, превышение
to cause smth, syn. to lead to smth to cause smbd to do smth a cause cause-and-effect relationship	вызвать что-либо заставить к-л сделать что-либо причина причинно-следственная связь
a measure to measure	мера измерять
in terms of	в каком-либо выражении
Gross Domestic Product (GDP)	ВВП
individuals, syn. persons	физические лица
Retail Price Index	индекс розничных цен
a sample to sample	образец, выборка, проба отбирать образцы
to weight weight	придавать вес вес, тяжесть, нагрузка
cost, costs to cost	стоимость, издержки стоить
a percentage	процентная доля
a reason for smth to reason reasoning	причина чего-либо рассуждать доводы
to raise money	мобилизовать средства
social security	социальное обеспечение
to contribute contributions	вносить вклад взносы

capital goods/ items	средства производства
to fund, syn. to finance funds a fund	финансировать денежные средства фонд
to lend, syn. to credit ant. to borrow a lender, syn. a creditor ant. a borrower lending, ant. borrowing	давать в долг, кредитовать (ант.) брать в долг кредитор (ант.) заемщик кредитование, заем
wealth	богатство, матер. ценности
to satisfy/to meet demand	удовлетворять спрос
wages salaries	зарплата рабочих зарплата офисных работников
to respond a response to smth	реагировать реакция, ответ на что-либо

1.3 Reading

Economic Essentials

All companies and voluntary or public sector organizations operate in an economic environment over which they have no control. This environment is subject to both cyclical movements and random shocks. Governments seek to lessen these influences by use of fiscal policy, monetary policy, or legislation. The government is also impelled by political considerations to try and change the social structure. It may seek to redistribute income, to increase or decrease the number and type of economic activities in the public sector, and make the economy more open to the international trade.

The economic variables which are most relevant to the businessman are:

- economic growth
- inflation
- interests rates
- unemployment

- public spending
- taxation

Other important economic influences on business are those relating to the international economy and market forces, which need further consideration.

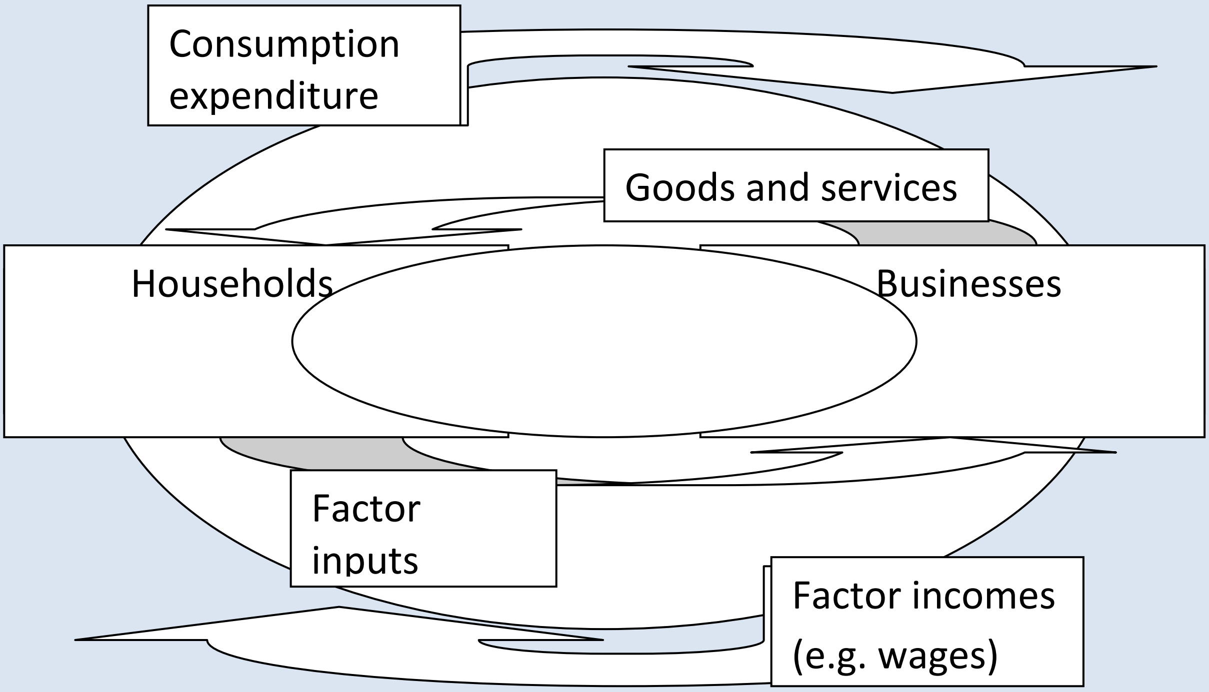

Fig.1 Simple circular flow model of national income

Economists see the economy as a system which generates a flow of goods and services produced by businesses for the use of households and consumers. A counter flow of payments takes place to the factor inputs used in the production of those goods and services (land, labour, capital and enterprise). This is illustrated in simple form in Figure 1. This 'circular flow' is a basic model of the relationship between flows of physical goods and money flows. The model may be refined to show the existence of a range of injections into, and leakages from, this simple circular flow model shown in Figure 2.

Any surplus of injections over leakages will increase the flow of income (create economic growth) while a surplus of leakages over injections will reduce the flow of income (cause negative economic growth). Since this flow of income passes through businesses, their activities will inevitably be affected and they will have to plan their activities with possible future changes in mind, if they are to survive and prosper.

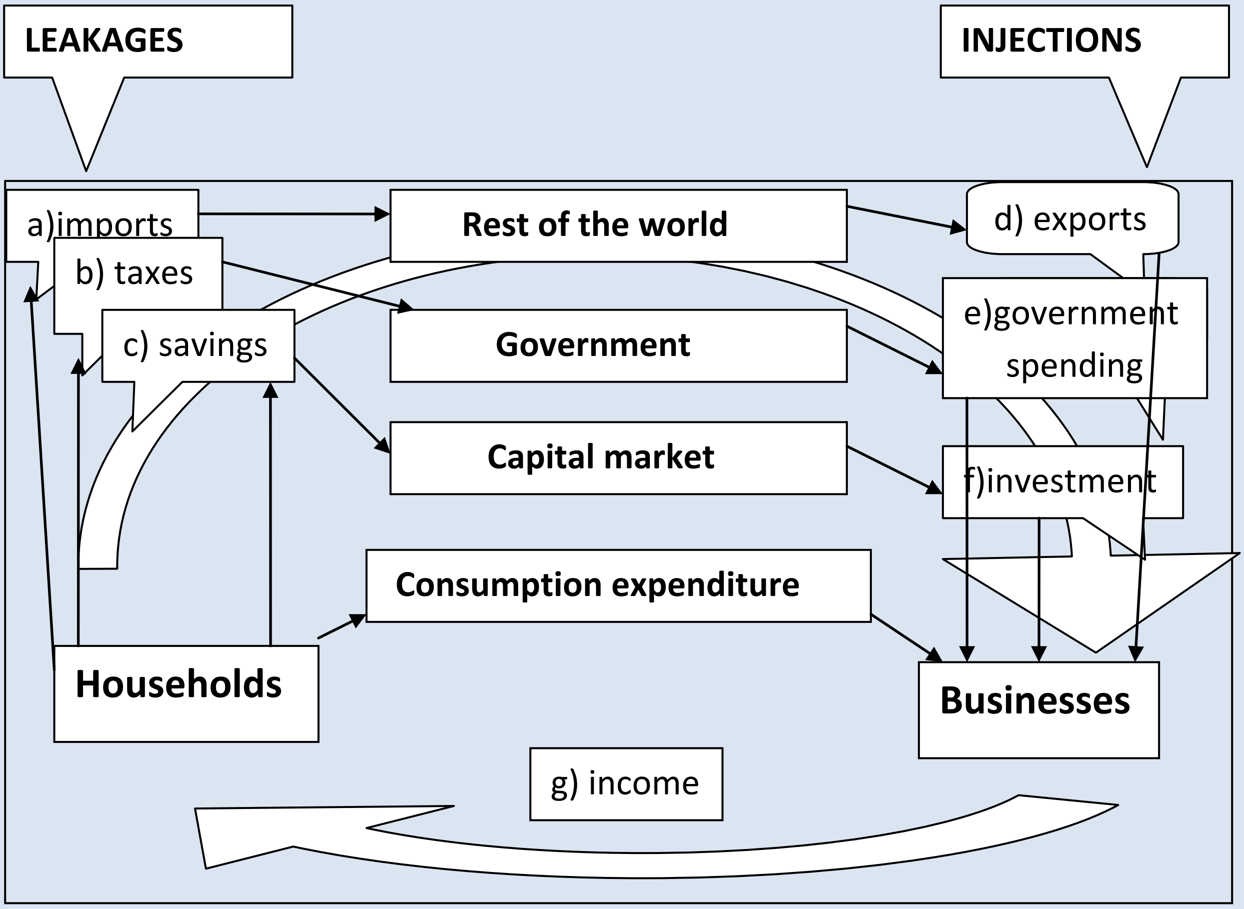

Fig. 2 Modified national income model

Governments seek by various means to manipulate items (a), (b), (c), (d), (e) or (f) in Fig.2 in order to maximize item (g), the flow of income in the system.

Economic growth is the most important of the economic indicators mentioned above. It is a measure of the rate at which the real output of the economy is growing over time. The effects of inflation are eliminated from our calculation.

The Gross Domestic Product (GDP) is the concept often used to measure output. This refers to the output produced by individuals and businesses actually located within the boundaries of the domestic economy.

Inflation is best defined as 'the persistent increase in the general level of prices over time'. Inflation is measured by the Retail Price Index (RPI). It is calculated by selecting a representative sample of goods normally purchased by households. The items are weighted for relative importance and the cost of the basket of goods today is expressed as a percentage of the same basket of goods in some ‘base’ year.

The measure of ***unemployment*** currently used is the number of persons ‘registered as unemployed and claiming benefit’. It has been suggested that this figure understates the true number of persons wishing to be economically active, but unable to find a job.

We must briefly note the reasons for ***public spending*** and the ways in which governments raise that money:

- defence and law and order
- social security
- local government spending
- national health service

These are the main items of government expenditure, but there are many others, including support of industry, contributions to the EC budget, infrastructure expenditure and other education spending. Public spending cuts most often concentrate on capital items, e.g. funding of road and railways construction, buildings, etc.

Government spending has to be financed either by taxation or by borrowing. ***Taxation*** is essential and unavoidable. It may be imposed on income, expenditure, capital gains or wealth. The main forms of taxation are as follows:

- income tax
- corporation tax
- value added tax
- excise duties
- capital gains and inheritance tax
- local taxation

An ***interest rate*** is the cost of borrowing money: the percentage of the amount of a loan paid by the borrower to the lender for the use of the lender’s money. A country’s minimum interest rate (the lowest rate that any lender can charge) is usually set by the central bank, as part of monetary policy, designed to keep inflation low. When interest rates fall, people borrow more, and spend rather than save, and companies invest more. When interest rates rise, so that borrowing becomes more expensive, individuals tend to save more and consume less, and companies invest less.

The managers of the firm must be aware of any changes of the above economic variables. They must seek to understand the economic process and be able to predict future developments.

1.4 Comprehension

1.4.1 Answer the questions using the active vocabulary.

1. Why do you think companies and voluntary or public sector organizations have no control over the economic environment in which they operate?
2. What do governments seek to do to lessen the influences of the changes in the economic environment?
3. What economic variables signal to the firm a possible change in the economic environment?
4. How do economists view the economy?
5. Describe the basic ‘circular flow’ model of the economy using Fig.1.
6. What can create growth according to the circular flow model shown in Fig.2?
7. What can cause negative economic growth according to the circular flow model shown in Fig.2?
8. What is economic growth?
9. What is GNP?
10 Define the concept of inflation and the way it can be measured.
11. What is meant by unemployment?
12. What are the reasons for public spending?
13. What can be used to finance public spending?
13. What are the main items of government expenditure?
14. What are the main forms of taxation?
15. What is an interest rate?
16. How do interest rates affect the rate of inflation?

1.4.2 Mark these statements T(true) or F(false) according to the information in the text. If they are false say why.

1. Economic environment is not affected by either cyclical movements or random shocks.

2. Fiscal policy, monetary policy and legislation are the government's instruments to lessen the influences of the economic environment.

3. The government does not seek to try and change the social structure.

4. Redistribution of income, increase or decrease of the number and type of economic activities in the public sector, and making the economy more open to the international trade may lead to social changes.

5. Businesses are not subject to major changes relating to the international economy and market forces.

6. Factor inputs used in the production of goods and services are wages, salaries and other incomes.

7. The flow of factor incomes is counter the flow of factor inputs.

8. Savings, exports and investment are leakages from the national income.

8. Exports and government spending are injections into the national income.

9. Governments seek by various means to maximize items (a), (b), (c), (d), (e) or (f) in Fig.2 in order to maximize item (g), the flow of income in the system.

10. Inflation is the persistent decrease in the general level of prices over time.

11. The effects of inflation are not eliminated from our calculation of growth.

12. It has been suggested that the number of persons registered as unemployed and claiming benefit is the true number of persons wishing to be economically active, but unable to find a job.

13. Support of industry, contributions to the European Community budget, infrastructure expenditure and education spending are the only items of public spending.

14. Public spending cuts most often concentrate on capital items such as healthcare and education.

15. Governments finance their spending by imposing taxes and borrowing from banks and the general public.

16. A country’s minimum interest rate (the highest rate that any lender can charge) is usually set by the central bank.

1.5 Language practice

1.5.1 Match the English terms in the left-hand column with the definition in the right-hand column.

1	input	A	Any sort of forced payment to the government.
2	index	B	The net ownership of material possessions and productive resources.
3	imports	C	A tax on the accounting profits of corporations.
4	output	D	A measure of the relative average of a group of items compared to a given base value.
5	monetary policy	E	The total market value of all goods and services produced by the citizens of an economy during a given period of time, usually one year.
6	fiscal policy	F	The increase in the value of a good at each stage of the production process.
7	a variable	G	The resources or factors of production used in the production of a firm's output.
8	tax	H	The average real gross domestic product per person--usually given the name per capita real GDP.
9	GDP	I	A generic term for a good or service that is the end result of the production/resource transformation process.
10	GNP	J	A central bank’s use of the money supply to stabilize the business cycle.
11	a living standard	K	A quantity, usually represented as a symbol, that can take on one of a set of values.
12	income	L	Goods and services produced by the foreign sector and purchased by the domestic

			economy
13	value added	M	The total market value of all goods and services produced within the political boundaries of an economy during a given period of time, usually one year.
14	corporation tax	N	Use of the federal government's powers of spending and taxation to stabilize the business cycle.
15	wealth	O	Revenue earned or received by households that can be used for consumption or saving.

1.5.2 Complete the following text using suitable words or phrases from the box below.

A	public spending	E	scarce resources
B	standard of living	F	cause problems
C	environment	G	output
D	opportunities	H	full employment

Why Is Growth Important?

The achievement of economic growth is important as a policy issue to all governments for a number of reasons:

- The rate of growth of ____1____ in relation to the rate at which the population grows, will determine the rate of increase of *output per capita* and therefore the rate at which the ____2____ improves over time.
- Strong economic growth means that the demand for goods and services will increase, offering ____3____ for new businesses to grow.
- Strong economic growth will also enable governments to increase ____4____.
- Strong economic growth will make ____5____ possible, but may ____6____ of high inflation and balance of payments deficits
- High economic growth levels may result in wasteful use of ____7____ and pollution of the ____8____.

1.5.3 Complete the text. Replace the Russian words and phrases by the English equivalents.

Inflation

There are three situations which can ***привести к*** inflation.

The first is the one in which the ***спрос на*** goods and services exceeds the ***предложение*** available. There may be a large supply of money available for one or more reasons because ***расходы правительства*** is relatively high; or because credit is easily available; or because people have relatively high ***имеющийся в распоряжении свободный доход***. When people want to spend money on ***товары и услуги*** but there are not enough of them to ***удовлетворить спрос***, ***цены растут*** accordingly. This is often referred to as "demand-pull inflation".

The second situation which ***вызывает инфляцию*** is the one in which production costs include ***сырье***, energy and ***заработную плату***. Increased production costs cause prices to rise. This is often referred to as "cost-push inflation".

These two ***причины инфляции*** are often interrelated so that one situation leads to the other which in turn leads to a recurrence of the first situation. This ***причинно-следственная цепочка*** is called an "inflationary spiral".

A third cause of inflation may be the government. Governments can ***повлиять на цены*** by controlling or regulating them, or by reducing ***налоги на товары и услуги*** and, accordingly, keeping prices down. If a government does not regulate prices or if it ***установит более высокие налоги*** (such as VAT) it may push prices up.

1.5.4 Text for discussion.

a. Look up the dictionary for the meaning and pronunciation of the following words and word-combinations and use them to discuss the problems outlined in the text.

To be aware of, to operate in an economic environment, to predict the likely changes, government responses, key economic variables, to enable, to maximize profits, to ensure survival, recognition, downturn in growth, gearing, borrowing, stock, capacity, upturn in growth, quality, delivery, service, value added, to shift production off-shore, a low wage economy, expansion of the firm, equity financing, loan finance, cutbacks of all costs, skilled labor, to recruit, corporation tax, tax allowances, personal taxation, marketing strategies, pricing policies.

b. Briefly scan the text and outline the list of major points.

c. Read the text more carefully and comment on the following items:

-The reasons for any businessperson to be aware of the condition of the economic environment in which he or she is operating.

-The measures which businessmen might take in response to changes in growth.

- The measures which businessmen might take in response to changes in the rate of inflation.

- The measures which businessmen might take in response to changes in the level of unemployment.

-The measures which businessmen might take in response to changes in the interest rates.

-The measures which businessmen might take in response to changes in taxation and public spending.

Implications for Business People

It is essential for any business person to be aware of the condition of the economic environment in which he or she is operating. The ability to predict the likely changes of key economic variables and the likely government responses to them may enable business people to maximize profits or growth or at least ensure survival. These are some of the responses which they might make.

- Recognition of a likely downturn in growth may allow the business to reduce excessive ‘gearing’ (borrowing), stock, too many employees and too much capacity.
- Recognition of a likely upturn in growth may cause the businessperson to take the opposite decisions. Greater production capacity and stock levels can be put in place to provide for future increases in sales.
- Businesses operating in a high inflation climate will be wise not to compete with foreign producers in prices, and instead to compete in terms of quality, delivery, service and value added.
- In extreme cases of inflation it may be wise to shift production off-shore to a low wage economy.
- Since high inflation leads to high interest rates, the successful business is the one which reduces its borrowing.
- Any expansion of the firm should be based on equity financing, rather than on loan finance in the period of high interest rates.
- A rise in the level of unemployment will signal to the firm a possible fall in demand, which requires cutbacks of all costs.
- A fall in unemployment may cause difficulties. Suitable skilled labor may then be hard to recruit and wage levels may rise rapidly.
- Changes in the rules of company taxation must be constantly monitored in order to minimize the corporation tax and to maximize the use of tax allowances available.
- Changes in personal taxation will affect the demand for goods and services. Businesses should change their marketing strategies and pricing policies to avoid loss of markets.

1.6 Render the passage in English using the English equivalents of the italicized phrases given in Russian. Express the main idea of the passage in one sentence or entitle it.

Правительство *финансирует* **(finance)** большую часть своих расходов *за счет налоговых поступлений* **(by taxation)**. Если правительство тратит больше, чем *получает в виде налогов* **(they levy or charge in taxes)**, ему приходится брать деньги в долг.

Прямые налоги **(direct taxex)** *взимаются* **(are collected)** правительством с доходов *физических и юридических лиц* **(individuals and businesses)**.

- Физические лица платят *подоходный налог с* **(income tax on)** *заработной платы* **(wages and salaries)** и всех остальных видов дохода.
- В большинстве стран существует *налог на прирост капитала* **(capital gains tax)** от прибыли, полученной от продажи *активов* **(assets)**, таких как *акции* **(shares or stocks)**.
- Компании платят *налог на прибыль* **(corporation tax on profits)**.
- Компании и их работники платят *налог национального страхования* **(national insurance tax)** (в Великобритании), денежные средства от которого правительство тратит на *социальное обеспечение* **(social security spending)** – *выплаты безработным, больным и так далее* **(unemployment pay, sick pay, etc.)**.
- *Налог на передачу капитала* **(Capital transfer tax)** обычно устанавливается на *унаследованные деньги или собственность* **(inherited money or property)**.

Косвенные налоги **(Indirect taxes)** *устанавливаются на* **(are levied on)** производство или продажи товаров и услуг. Они *включены в цену* **(are included in the price)**, *установленную для конечного потребителя* **(paid by the final purchaser)**.

- *Налог на добавленную стоимость* **(value-added tax)** взимается *на каждой стадии* **(at each stage of)** производства *на основе стоимости, добавленной* **(based on the value added)** к продукту на данной стадии. *Общая сумма* **(the whole amount of)** налога добавляется к *конечной цене* **(the final price)** на продукт, которую оплатит конечный покупатель.
- В США существуют *налоги с продаж* **(sales taxes)**, сумму которых *розничные продавцы* **(retailers)** *включают в* **(levy on)** *розничную* **(retail)** цену на товар.

- Правительство взимает *акцизный налог или пошлину* **(excise taxes or duties)** – *дополнительный* **(additional)** налог с продаж таких товаров, как *табачные изделия* **(tobacco products),** *алкогольные напитки* **(alcoholic drinks)** и *бензин* **(petrol)**.
- Особые налоги - *тарифы* **(tariffs)** – часто *устанавливаются на* **(charged on)** *импортные товары* **(imported goods)**.

Unit 1 Reading Self – Control Test
Economic Essentials

1. Which of the following is the main idea of the text?

(A) The cumulative effects of the changes of basic economic variables on the firm.

(B) The basic economic variables.

(C) Circular flow model of national income.

(D) Modified national income model.

2. What is most likely the source the text has been taken from?

(A) a government’s report

(B) a textbook

(C) a newspaper

(D) a firm’s financial report

3. It can be derived from the text that “leakages” can be defined as

(A) output

(B) the resources or factors of production used in the production of a firm's output.

(C) a non-consumption expenditure on gross domestic product, including investment expenditures, government purchases, and exports.

(D) a non-consumption use of income, including savings, taxes, and imports.

4. It can be inferred from the text that "injections" can be defined as

(A) input

(B) the resources or factors of production used in the production of a firm's output.

(C) a non-consumption expenditure on gross domestic product, including investment expenditures, government purchases, and exports.

(D) a non-consumption use of income, including savings, taxes, and imports.

5. Judging by what you have derived from the text, which do you think of the basic economic variables can be defined as "The general condition in which resources are willing and able to produce goods and services but are not engaged in productive activities"?

(A) inflation

(B) public spending

(C) unemployment

(D) taxation

6. It can be derived from the text that a tax placed on a product whenever value is added at a stage of production and at final sale is typically referred to as

(A) capital gains and inheritance tax

(B) value added tax

(C) excise duties

(D) corporation tax

7. It can be derived from the text that the lowest rate that any lender can charge is

(A) set by the lender.

(B) set by the commercial bank.

(C) set by the central bank.

(D) negotiated by the lender and borrower.

8. Which of the following statements would the author most probably agree with?

(A) Factor inputs used in the production of goods and services are wages, salaries and other incomes.

(B) Public spending cuts most often concentrate on capital items such as healthcare and education.

(C) The Gross Domestic Product is the concept often used to measure inputs.

(D) Investment is a source of economic growth.

9. Which of the following statements would the author most probably disagree with?

(A) The flow of production, income, and resources between producers and consumers moves through product markets as the gross domestic product of our economy and is then the revenue received by the business sector in payment for this production.

(B) The key economic function of the business sector is the production of goods and services.

(C) Businesses are not subject to major changes relating to the international economy and market forces.

(D) The basic macroeconomic sectors are the business sector, the household sector, the government sector, and the foreign sector.

10. What is most likely the subject of the extract which is missing from this text?

(A) commercial banking

(B) changes of economic variables and implications for businessmen

(C) central banking

(D) accounting policies

Unit 1 Glossary

BUSINESS SECTOR: The basic macroeconomic sector containing the private, profit-seeking firms in the economy that combine scarce resources into the production of wants-and-needs satisfying goods and services. The key economic function of the business sector is the production of goods and services. The three basic types of business organizations that comprise the business sector are proprietorship, partnership, and corporation. This is one of the four macroeconomic sectors. The other three are household sector, government sector, and foreign sector.

CAPITAL GAINS TAX A type of tax levied on capital gains incurred by individuals and corporations. Capital gains are the profits that an investor realizes when he or she sells the capital asset for a price that is higher than the purchase price.

CAPITAL GOOD: A good that is a manufactured (or previously produced) factor of production that is used to manufacture or produce other things. Common examples of capital goods are the factories, buildings, trucks, tools, machinery, and equipment used by businesses in their productive pursuits. The acquisition of capital goods is the primary goal of business investment.

CAPITAL: One of the four basic categories of resources, or factors of production. It includes the manufactured (or previously produced) resources used to manufacture or produce other things. Common examples of capital are the factories, buildings, trucks, tools, machinery, and equipment used by businesses in their productive pursuits.

CIRCULAR FLOW: The continuous movement of production, income, and resources between producers and consumers. This flow moves through product markets as the gross domestic product of our economy and is then the revenue received by the business sector in payment for this production. This stream of revenue then flows through resource markets as payments by businesses for the resources employed in production. The payments received by resource owners, however, is nothing more than the income of the household sector. The resource owners of the household sector use this income to purchase goods and services through the product markets, coming full circle to where we began.

CONSUMER PRICE INDEX: (CPI) measures changes through time in the price level of consumer goods and services purchased by households. The CPI is defined by the United States Bureau of Labor Statistics as "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

CONSUMPTION EXPENDITURE: The common term for an expenditure by the household sector on gross domestic product. In general consumption expenditures is included the wide assortment of goods and services purchased by the household sector which provides satisfaction of wants and needs.

CORPORATE INCOME TAX: A tax on the accounting profits of corporations. This tax is only levied on corporations, and excludes businesses that are proprietorships or partnerships.

CORPORATION: One of the three basic forms of business organization (the other two are proprietorship and partnership). A corporation is a business established through ownership shares (termed corporate stock). A corporation is considered a distinct legal person, that can be sued, forced to pay taxes, etc., just like a human person. Unlike proprietorships and partnerships businesses, a corporation business exists separately from its owners. As such, the owners have what lawyer-types term limited liability. Owners cannot be held personally responsible for corporate debts. The owners can only lose the value of their ownership shares, but no more.

CREDITOR: An entity (person or institution) that extends credit by giving another entity permission to borrow money if it is paid back at a later date.

ECONOMIC GROWTH: The long-run expansion of the economy's ability to produce output. This is one of five economic goals, specifically one of the three macro goals (stability and full employment are the other two). Economic growth is made possible by increasing the quantity or quality of the economy's resources (labor, capital, land, and entrepreneurship).

ECONOMIC DEVELOPMENT: The process of improving the economy's ability to satisfy consumers wants and needs. Unlike economic growth, which is concerned with year to year increases in production, economic development deals more with the basic fabric of society, especially the institutions that govern the way our economy and society functions.

ECONOMIC EFFICIENCY: Obtaining the most consumer satisfaction from available resources.

EMPLOYMENT: The condition in which a resource (especially labor) is actively engaged in a productive activity usually in exchange for payment (such as wage or salary).

ENTERPRISE: An organization that combines scarce resources for the production and supply of goods and services. The term enterprise is generally used synonymously with other terms such as business, firm, and company.

ENVIRONMENT: All of the naturally occurring stuff that came with the planet, before it's been altered, extracted, transformed, or used up for production. It includes the air, water, land, vegetation, and wildlife.

EXCHANGE RATE: The price of one nation's currency in terms of another nation's currency. This is often called the foreign exchange rate in that it is the price determined in the foreign exchange market when people buy and sell foreign exchange.

EXCHANGE: The process of trading one item for another. Exchange is fundamental to the study of economics, markets, and market-oriented economies. Most exchanges in a modern, complex market-oriented economy involve a commodity on one side and a monetary payment (that is, price) on the other.

EXCISE TAX: A tax on a specific good. This should be compared with a general sales tax, which is a tax on all (or nearly all) goods sold. The most common excise taxes are on alcohol, tobacco, and gasoline.

EXPORT: The sale of goods to a foreign country.

FACTOR INCOME It is the returns received on factors of production: rent is return on land, wages on labor, interest on capital, and profit on entrepreneurship. It is also known as Net Factor Payments (NFP).

FINANCE: The science that describes the management of money, banking, credit, investments, and assets.

FISCAL POLICY: Use of the federal government's powers of spending and taxation to stabilize the business cycle.

GDP: The total market value of all goods and services produced within the political boundaries of an economy during a given period of time, usually one year. This is the government's official measure of how much output our economy produces.

GIFT TAX: A tax on the transfer of assets from one person to another. The gift tax is different from estate and inheritance taxes in that it applies to people who are still alive.

GNP: The abbreviation for gross national product, which is the total market value of all goods and services produced by the citizens of an economy during a given period of time, usually one year.

GROWTH RATE: The percentage change in a variable from one year to the next. The growth rate, in effect, measures how much the variable is growing over time.

HOUSEHOLD SECTOR: The basic macroeconomic sector that includes the entire, wants and-needs-satisfying population of the economy. The household sector is the eating, breathing, consuming population of the economy.

HOUSEHOLD: The consuming population of an economy, which pretty much includes every living, breathing human being in a nation. The key contrast here is with business, the organizations responsible for production. In terms of the circular flow, households buy production from businesses through product markets and supply resources to business through factor markets.

IMPORTS: Goods and services produced by the foreign sector and purchased by the domestic economy. In other words, imports are goods purchased from other countries.

INCOME TAX: A tax on income, including wages, rent, interest, profit, and (usually) transfer payments. The income tax system in the United States includes both a personal income tax and corporate income tax.

INCOME: Revenue earned or received by households that can be used for consumption or saving.

INFLATION: A persistent increase in the average price level in the economy. Inflation occurs when the AVERAGE price level (that is, prices IN GENERAL) increases over time.

INHERITANCE TAX: A tax on that portion of the Assets of a deceased person that's received by another.

INJECTION: A non-consumption expenditure on gross domestic product, including investment expenditures, government purchases, and exports. Injections are combined with leakages in the injection-leakage model used to identify equilibrium aggregate output in Keynesian economics.

INJECTION-LEAKAGE MODEL: A model used in Keynesian economics based on the equality of non-consumption expenditures (or injections) and non-consumption uses of income (leakages). On one side of the equality is savings, taxes, and imports -- the non-consumption leakages. On the other side of the equality is investment, government purchases, and exports -- the non-consumption injections.

INPUT: The resources or factors of production used in the production of a firm's output.

INSURANCE: Transferring risk to others. The need for insurance occurs because people tend to be risk averse in many circumstances.

INTEREST RATE: The price of funds expressed as a percentage of the total amount loaned or borrowed. This is the cost of borrowing funds and the payment received for lending. Interest rates are invariably expressed as an annual percentage of the amount borrowed/loaned.

INTEREST: Payments for the use of borrowed funds. Interest is most commonly expressed as a percent of the borrowed funds, which is an interest rate.

INVESTMENT: The sacrifice of current benefits or rewards to pursue an activity with expectations of greater future benefits or rewards. Investment is typically used to mean the purchase of capital by business in anticipation of the profit. By increasing the quantity or quality of resources, investment is a source of economic growth.

LABOR FORCE: The total number of people willing and able to exert mental and/or physical efforts in productive activities.

LABOR: One of the four basic categories of resources, or factors of production (the other three are capital, land, and entrepreneurship). Labor is the services and efforts of humans that are used for production. While labor is commonly thought of as those who work in factories, it includes all human efforts (except entrepreneurship), such as those provided by clerical workers, technicians, professionals, managers, and even company presidents.

LAND: One of four basic categories of resources, or factors of production (the other three are labor, capital, and entrepreneurship). This category includes the natural resources used to produce goods and services, including the land itself; the minerals and nutrients in the ground; the water, wildlife, and vegetation on the surface; and the air above.

LEAKAGE: A non-consumption use of income, including savings, taxes, and imports. Leakages are combined with injections in the injection-leakage model used to identify equilibrium aggregate output in Keynesian economics.

MACROECONOMY: The aggregate, or national economy that is the prime focus of the study of macroeconomics.

MONETARY: Relating to money, usually used as a modifier with other terms, generating such concepts as monetary policy, monetary unit, and monetary authority.

MONETARY POLICY: The Federal Reserve System's use of the money supply to stabilize the business cycle. As the nation's central bank, the Federal Reserve System determines the total amount of money circulating around the economy. In principle, the Fed can use three different "tools"--open market operations, the discount rate, and reserve requirements--to manipulate the money supply.

OPEN ECONOMY: An economy with a great deal of foreign trade. At the extreme, a completely open economy is one that has no trade barriers.

OUTPUT: A generic term for a tangible good or an intangible service that is the end result of the production/resource transformation process.

PERSONAL INCOME TAX: A tax on individual income. This is the primary source of revenue for the federal government, a big source for many state and local governments.

PRIVATE SECTOR: A short-cut term that combines the households and businesses in the economy into a single group. This term should be contrasted directly with public sector, which is a comparable short-cut term for government.

PRODUCT: A generic term for a tangible good, an intangible service, or an idea. This is the "output" of any production process.

PRODUCTION: The process of transforming the natural resources of the land into consumer satisfying consumption and capital goods using scarce resources.

PUBLIC SECTOR: A term for government, which for the United States includes all three levels--federal, state, and local. The term public sector is most useful as a contrast to the term private sector, which includes households and businesses.

RETAIL PRICES INDEX: (RPI) It is the most familiar general purpose measure of inflation in the UK. It measures the average change from month to month in the prices of goods and services purchased by most households in the United Kingdom.

SALARY: Money paid monthly by an employer to office workers.

SAVINGS: According to Keynesian economics, the amount left over when the cost of a person's consumer expenditure is subtracted from the amount of disposable income that he or she earns in a given period of time.

SOCIAL SECURITY TAX: A tax on wage earnings that's used to fund the Social Security system. In principle, the Social Security tax is divided equally between employer and employee.

SOCIAL SECURITY: A system for providing financial assistance to the poor, elderly, and disabled. The social security system in the United States was established by the Social Security Act (1935) in response to the devastating problems of the Great Depression.

SPENDING: The amount of money spent by households in an economy. The spending includes durables, such as washing machines, and nondurables, such as food. It is also known as consumption, and is measured monthly. John Maynard Keynes considered consumer spending to be the most important determinant of short-term demand in an economy.

STANDARD OF LIVING: In principle, an economy's ability to produce the goods and services that consumers use to satisfy their wants and needs. In practice, it is the average real gross domestic product per person--usually given the name per capita real GDP.

SUBSIDY: A payment from government to individuals or businesses without any expectations of production.

SUBSTITUTE-IN-PRODUCTION: One of two goods that can replace each other in production--that is, using resources to produce one good prevents their use in the other.

SURPLUS: A condition in the market in which the quantity supplied is greater than the quantity demanded at the existing price.

TAX: Any sort of forced payment to government. The primary reason government collects taxes is to get the revenue needed to finance public goods and pay administrative expenses.

UNEMPLOYMENT: The general condition in which resources are willing and able to produce goods and services but are not engaged in productive activities. While unemployment is most commonly thought of in terms of labor, any of the other factors of production (capital, land, and entrepreneurship) can be unemployed as well.

VALUE-ADDED TAX: A type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale.

VARIABLE: A quantity, usually represented as a symbol, that can take on one of a set of values. Variables play a key role in the scientific method and economic analysis.

WAGES: Money paid by the day or the hour for manual work, usually received weekly.

WEALTH: The net ownership of material possessions and productive resources. In other words, the difference between physical and financial assets that you own and the liabilities that you owe.