

Glossary of Key Terms

A

Absolute advantage The greater efficiency that one nation may have over another in the production of a commodity. This was the basis for trade for Adam Smith.

Absolute purchasing-power parity theory Postulates that the equilibrium exchange rate is equal to the ratio of the price levels in the two nations. This version of the PPP theory can be very misleading.

Absorption approach Examines and integrates the effect of induced income changes in the process of correcting a balance-of-payments disequilibrium by a change in the exchange rate.

Accommodating transactions Transactions in official reserve assets required to balance international transactions; also called below-the-line items.

Ad valorem tariff A tariff expressed as a fixed percentage of the value of a traded commodity.

Adjustable peg system The system under which exchange rates or par values are periodically changed to correct balance-of-payments disequilibria.

Adjustment The process by which balance-of-payments disequilibria are corrected.

Adjustment in the balance of payments The operation and effects of the mechanisms for correcting balance-of-payments disequilibria.

Adjustment policies Specific measures adopted by a nation's monetary authorities for the primary purpose of correcting a balance-of-payments disequilibrium.

Aggregate demand (AD) curve The graphical relationship between the total quantity demanded of goods and services at various prices.

Aggregate supply (AS) curve The graphical relationship between the nation's output and the price level over a given time period.

Antiglobalization movement The loose organization that blames globalization for many human and environmental problems throughout the world and for sacrificing human and environmental well-being to the corporate profits of multinationals (Sect. 9.7B).

Antitrade production and consumption Increases in production and consumption that lead to a smaller than proportionate increase (or even an absolute decline) in the volume of trade.

Appreciation A decrease in the domestic currency price of the foreign currency.

Arbitrage The purchase of a currency in the monetary center where it is cheaper for immediate resale in the monetary center where it is more expensive in order to make a profit.

Autarky The absence of trade, or isolation.

Autonomous transactions International transactions that take place for business or profit motives (except for unilateral transfers) and independently of balance-of-payments considerations; also called above-the-line items.

Average propensity to import (APM) The ratio of imports to national income, or M/Y .

B

Balance of payments A summary statement of all the international transactions of the residents of a nation with the rest of the world during a particular period of time, usually a year.

Balanced growth Equal rates of factor growth and technological progress in the production of both commodities.

Balassa-Samuelson effect The higher ratio in the price of nontraded goods and services to the price of traded goods in developed rather than in developing nations, and overvalued exchange rates in the former relative to the latter.

Baltic Free Trade Agreement (BAFTA) The agreement among the Baltic States of Estonia, Latvia, and Lithuania setting up a free trade area among themselves.

Basis for trade The forces that give rise to trade between two nations. This was absolute advantage according to Adam Smith and comparative advantage according to David Ricardo.

Benign neglect The policy of nonintervention in foreign exchange markets followed by the United States from March 1973 until the end of 1977 and from 1981 to 1985.

Bilateral agreements Agreements between two nations regarding quantities and terms of specific trade transactions.

Bilateral trade Trade between any two nations.

BP curve The usually positively inclined curve showing the various combinations of interest rates and national income levels at which the nation's balance of payments is in equilibrium.

Brain drain The migration of highly skilled and trained people from developing to developed nations and from other industrial nations to the United States.

Bretton Woods system The gold-exchange standard that operated from the end of World War II until 1971.

Buffer stocks The type of international commodity agreement that involves the purchase of the commodity (to be added to the stock) when the commodity price falls below an agreed minimum price, and the

Buffer stocks sale of the commodity out of the stock when the commodity price rises above the established maximum price.

Bulk purchasing An agreement to purchase a specified amount of a commodity for a year or a number of years.

C

Capital account It includes debt forgiveness and goods and financial assets that migrants take with them as they leave or enter the country.

Capital-intensive commodity The commodity with the higher capital-labor ratio at all relative factor prices.

Capital-labor ratio (K/L) The amount of capital per unit of labor used in the production of a commodity.

Capital-saving technical progress Technical progress that increases the productivity of labor proportionately more than the productivity of capital and results in an increase in L/K at constant relative factor prices.

Carry trade The strategy in which an investor borrows low-yielding currencies and lends (invests in) high-yielding currencies.

Central and Eastern European Countries (CEEC) Includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, the Federal Republic of Yugoslavia, Hungary, the former Yugoslav Republic (FYR), Macedonia, Poland, Romania, the Slovak Republic, and Slovenia.

Central European Free Trade Association (CEFTA) The agreement signed by Poland, Hungary, the Czech Republic, and Slovakia in 1992 calling for the establishment of free trade among its members within ten years (subsequently anticipated for 1997).

Centralized cartel An organization of suppliers of a commodity that behaves as a monopolist.

Centrally planned economies Economies in which factors of production are owned by the government and prices are determined by government directives.

Closed economy An economy in autarky or not engaging in international transactions.

Cobb-Douglas production function The production function exhibiting a unitary elasticity of substitution between labor and capital.

Commercial policies The regulations governing a nation's commerce or international trade.

Commodity, or net barter, terms of trade The ratio of the price index of the nation's exports to the price index of its imports times 100.

Common market Removes all barriers on trade among members, harmonizes trade policies toward the rest of the world, and also allows the free movement of labor and capital among member nations. An example is the European Union (EU) since January 1, 1993.

Commonwealth of Independent States (CIS) The organization formed by most of the former Soviet Republics when the Soviet Union was dissolved at the end of 1991.

Community indifference curve The curve that shows the various combinations of two commodities yielding equal satisfaction to the community or nation. Community indifference curves are negatively sloped, convex from the origin, and should not cross.

Comparative statics Studies and compares two or more equilibrium positions (resulting from changes in underlying economic conditions) without regard to the transitional period and process of adjustment.

Complete specialization The utilization of all of a nation's resources in the production of only one commodity with trade. This usually occurs under constant costs.

Compound tariff A combination of an ad valorem and a specific tariff.

Confidence The knowledge that the balance-of-payments adjustment mechanism is working adequately and that international reserves will retain their absolute and relative values.

Constant elasticity of substitution (CES) production function The production function exhibiting a constant (but not necessarily unitary) elasticity of substitution between labor and capital.

Constant opportunity costs The constant amount of a commodity that must be given up to produce each additional unit of another commodity.

Constant returns to scale The condition under which output grows in the same proportion as factor inputs.

Consumer surplus The difference between what consumers are willing to pay for a specific amount of a commodity and what they actually pay for it.

Consumption effect of a tariff The reduction in domestic consumption of a commodity resulting from the increase in its price due to a tariff.

Consumption function The relationship between consumption expenditures and income. In general, consumption is positive when income is zero (i.e., the nation dissaves) and rises as income rises, but by less than the rise in income.

Council of Mutual Economic Assistance (CMEA or COMECON) The organization of Communist bloc nations formed by the Soviet Union in 1949 to divert trade from Western nations and achieve a greater degree of self-sufficiency among Communist nations.

Countervailing duties (CVDs) Tariffs imposed on imports to offset subsidies by foreign governments.

Covered interest arbitrage The transfer of short-term liquid funds abroad to earn higher returns with the foreign exchange risk covered by the spot purchase of the foreign currency and a simultaneous offsetting forward sale.

Covered interest arbitrage margin (CIAM) The interest differential in favor of the foreign monetary center minus the forward discount on the foreign currency, or the interest differential in favor of the home monetary center minus the forward premium on the foreign currency.

Covered interest arbitrage parity (CIAP) The situation where the interest differential in favor of the foreign monetary center equals the forward discount on the foreign currency.

Crawling peg system The system under which par values or exchange rates are changed by very small preannounced amounts at frequent and clearly specified intervals until the equilibrium exchange rate is reached.

Credit tranche The amounts that a member nation could borrow from the IMF, subject to conditions, over and above the gold tranche.

Credit transactions Transactions that involve the receipt of payments from foreigners. These include the export of goods and services, unilateral transfers from foreigners, and capital inflows.

Cross-exchange rate The exchange rate between currency A and currency B, given the exchange rate of currency A and currency B with respect to currency C.

Currency board arrangements (CBAs) The exchange rate arrangement whereby the nation rigidly fixes the exchange rate and its central bank loses its ability to conduct an independent monetary policy by allowing the nation's supply to increase or decrease only in response to balance-of-payments surpluses or deficits.

Currency convertibility The ability to exchange one national currency for another without any restriction or limitation.

Current account The account that includes all sales and purchases of currently produced goods and services, income on foreign investments, and unilateral transfers.

Customs union Removes all barriers on trade among members and harmonizes trade policies toward the rest of the world. The best example is the European Union (EU).

D

Debit transactions Transactions that involve payments to foreigners. These include the import of goods and services, unilateral transfers to foreigners, and capital outflows.

Deficit in the balance of payments The excess of debits over credits in the current and capital accounts, or autonomous transactions; equal to the net *credit* balance in the official reserve account, or accommodating transactions.

Deindustrialization The decline in the relative importance of manufacturing and in the share of manufacturing employment.

Demand for money According to the monetary approach, the nation's demand for nominal money balances is stable in the long run and is directly related to nominal national income but inversely related to the rate of interest in the nation.

Depreciation An increase in the domestic currency price of the foreign currency.

Derived demand The demand for factors of production that arises from the demand for final commodities that are produced using the particular factors.

Desired or planned investment The level of investment expenditures that business would like to undertake.

Destabilizing speculation The sale of a foreign currency when the exchange rate falls or is low, in the expectation that it will fall even lower in the future, or the purchase of a foreign currency when the exchange rate is rising or is high, in the expectation that it will rise even higher in the future.

Devaluation A deliberate (policy) increase in the exchange rate by a nation's monetary authorities from one fixed or pegged level to another.

Differentiated products The somewhat different products (such as automobiles, cigarettes, and soaps) produced by different manufacturers in the same industry or general product group.

Direct controls Tariffs, quotas, and other restrictions on the flow of international trade and capital.

Direct investments Real investments in factories, capital goods, land, and inventories where both capital and management are involved and the investor retains control over the use of the invested capital.

Dirty floating Managing the nation's exchange rate to achieve aims other than simply the smoothing out of short-term fluctuations, for example, keeping the nation's currency undervalued so as to stimulate exports.

Doha Round The multilateral trade negotiations launched in November 2001 in Doha (Qatar) and scheduled to be completed in 2004, that will address, among other things greater trade access by developing countries in developed countries' markets.

Dollar glut The excess supply of dollars in the hands of foreign monetary authorities that developed during the late 1950s and early 1960s.

Dollar overhang The large amount of foreign-held dollars resulting from past U.S. balance-of-payments deficits, the movement of which from monetary center to monetary center can lead to large exchange rate fluctuations and complicates the conduct of monetary policies.

Dollar shortage The inability of war-torn nations during the late 1940s and early 1950s to accumulate substantial dollar reserves.

Dollar standard The international monetary system that emerged from the Smithsonian Agreement in December 1971 under which the U.S. dollar remained an international currency and reserve without any gold backing.

Dollarization The situation whereby a nation adopts another nation's currency as its legal tender.

Domestic value added Equals the price of a final commodity minus the cost of the imported inputs going into the production of the commodity.

Double-entry bookkeeping The accounting procedure whereby each (international) transaction is entered twice, once as a credit and once as a debit of an equal amount.

Double factorial terms of trade The ratio of the price index of the nation's exports to the price index of its imports times the ratio of the productivity index in the nation's export sector to the productivity index in the nation's import-competing sector.

Dumping The export of a commodity at below cost or at a lower price than sold domestically.

Dutch disease The appreciation of a nation's currency resulting from the exploitation of a domestic resource that was previously imported, and the resulting loss of international competitiveness in the nation's traditional sector.

Duty-free zones or free economic zones Areas set up to attract foreign investments by allowing raw materials and intermediate products duty free.

Dynamic analysis Deals with the time path and process of adjustment from one equilibrium position to another.

Dynamic external economies The decline in the average cost of production as cumulative industry output increases and firms accumulate knowledge over time.

E

Economic integration The commercial policy of discriminatively reducing or eliminating trade barriers only among the nations joining together.

Economic union Removes all barriers on trade among members, harmonizes trade policies toward the rest of the world, allows the free movement of labor and capital among member nations, and also harmonizes or unifies the monetary, fiscal, and tax policies of its members.

- Edgeworth box diagram** The diagram constructed from the isoquants of two commodities and the given quantities available of two factor inputs.
- Effective exchange rate** A weighted average of the exchange rates between the domestic currency and the nation's most important trade partners, with weights given by the relative importance of the nation's trade with each of these trade partners.
- Efficiency of foreign exchange markets** The situation in which forward exchange rates accurately predict future spot rates.
- Elasticity approach** The change in the trade balance resulting from a depreciation or devaluation and depending on the price elasticity of demand for the nation's exports and imports.
- Elasticity of substitution** The degree or ease with which one factor can be substituted for another in production when the price of the factor declines.
- Elasticity pessimism** The belief, arising from the empirical studies of the 1940s, that foreign exchange markets were either unstable or barely stable.
- Endogenous growth theory** The theory that seeks to identify in detail and rigorously the actual channels or the ways by which freer trade leads to faster long-run economic growth and development.
- Engine of growth** The view that exports were the leading sector that propelled the economies of the regions of recent settlement into rapid growth and development during the nineteenth century.
- Environmental standards** The level of pollution accepted in various countries.
- Equilibrium level of national income (Y_E)** The level of income at which desired or planned expenditures equal the value of output, and desired saving equals desired investment.
- Equilibrium-relative commodity price in isolation** The relative commodity price at which a nation is maximizing its welfare in isolation. It is given by the slope of the common tangent to the nation's production frontier and indifference curve at the autarky point of production and consumption.
- Equilibrium-relative commodity price with trade** The common relative commodity price in two nations at which trade is balanced.
- Escape clause** A protectionist device that allowed any industry that claimed injury from imports to petition the International Trade Commission, which could then recommend to the president to revoke any negotiated tariff reduction.
- Euler's theorem** The theorem that postulates that if constant returns to scale prevail in production and each factor is rewarded (paid) according to its productivity, the output produced is exhausted and just exhausted.
- Euro** The common currency adopted at the beginning of 1999 by 11 of the 15 member countries of the European Union.
- Eurobonds** Long-term debt securities sold outside the borrower's country to raise long-term capital in a currency other than the currency of the nation where the securities are sold.
- Eurocurrency** Commercial bank deposits in a nation denominated in a foreign currency.
- Eurocurrency market** The market where Eurocurrencies are borrowed and lent.
- Euronotes** Medium-term financial instruments falling somewhere between short-term Eurocurrency bank loans and long-term Eurobonds.
- European Central Bank (ECB)** The institution similar to the Federal Reserve System in the United States that would control the money supply and issue the single currency of the European Union to be set up by 1997 or 1999.
- European Currency Unit (ECU)** The unit of account defined by the European Monetary System, based on the weighted average of the currencies of the EU members.
- European Economic Area (EEA)** The free trade area formed by the 12 members of the EU and 5 of the 7 members of the EFTA on January 1, 1994.
- European Free Trade Association (EFTA)** The free trade area that was formed in 1960 by the United Kingdom, Austria, Denmark, Norway, Portugal, Sweden, and Switzerland, with Finland an associate member in 1961. Iceland acceded in 1970. In 1973, the United Kingdom and Denmark left the EFTA to join the EU. Finland became a full member of the EFTA in 1986 and Liechtenstein in 1991. In 1995, Austria, Finland, and Sweden left the EFTA and joined the EU.
- European Monetary Cooperation Fund (EMCF)** The institution of the European Monetary System that provides short-term and medium-term balance-of-payments assistance to member nations.
- European Monetary Institute (EMI)** The forerunner of the European Central Bank that was set up in January 1994 by the Maastricht Treaty of December 1991 to further centralize members' macroeconomic policies and reduce exchange rate fluctuation margins.
- European Monetary System (EMS)** The organization formed by the members of the European Union (EU) in 1979 based on the creation of the European currency unit (ECU) of account, limited exchange rate flexibility among members, and formation of the European Monetary Fund (EMF).
- European Monetary Union (EMU)** The 12 members of the European Union that have adopted the euro as their common currency and have established the European Central Bank to conduct their common monetary policy.
- European Union (EU)** The customs union formed by West Germany, France, Italy, Belgium, the Netherlands, and Luxembourg that came into existence in 1958, and expanded to 15 nations with the joining of the United Kingdom, Denmark, and Ireland in 1973, Greece in 1981, Spain and Portugal in 1986, and Austria, Finland, and Sweden in 1995.
- Exchange controls** Restrictions on international capital flows, official intervention in forward markets, multiple exchange rates, and other financial and monetary restrictions imposed by a nation.
- Exchange rate** The domestic currency price of the foreign currency.
- Exchange rate mechanism (ERM)** The arrangement of the European Monetary System under which the currencies of member countries were allowed to fluctuate by plus or minus 2.25 percent of their central rates.
- Exchange rate overshooting** The tendency of exchange rates to immediately depreciate or appreciate by more than required for long-run equilibrium, and then partially reversing their movement as they move toward their long-run equilibrium levels.
- Expansion path** The line joining the origin with points of producer's equilibrium obtained by increasing expenditures on inputs with input prices constant.
- Expected change in the spot rate** The change in the spot (exchange) rate that is expected to occur in the future.
- Expected prices** The prices that are believed will prevail.

Expenditure-changing policies Fiscal and monetary policies directed at changing the level of aggregate demand of the nation.

Expenditure-switching policies Devaluation or revaluation of a nation's currency directed at switching the nation's expenditures from foreign to domestic or from domestic to foreign goods.

Export controls The type of international commodity agreement that seeks to regulate the quantity of the commodity exported by each nation.

Export function The relationship between exports and income. With exports exogenous, the export function is horizontal. That is, exports are independent of (or do not change with) the level of national income.

Export-Import Bank A U.S. government agency that extends subsidized loans to foreigners to finance U.S. exports.

Export instability Short-run fluctuations in export prices and earnings.

Export-oriented industrialization The policy of industrialization pursued by some developing nations that involves increasing the output of manufactured goods for export.

Export pessimism The feeling that developing countries' exports to developed countries cannot grow rapidly because of the latter's increased protectionism.

Export subsidies The granting of tax relief and subsidized loans to potential exporters, and low-interest loans to foreign buyers of the nation's exports.

Export tariff A tax or duty on exports.

External balance The objective of equilibrium in a nation's balance of payments.

External economies The reduction in each firm's average costs of production as the entire industry output expands.

F

Factor abundance The factor of production available in greater proportion and at a lower relative price in one nation than in another nation.

Factor endowments See factor abundance.

Factor-intensity reversal The situation where a commodity is L intensive when the relative price of labor is low and K intensive when the relative price of capital is low. If prevalent, this would lead to rejection of the H-O trade model.

Factor-price equalization (H-O-S) theorem The part of the H-O theory that predicts, under highly restrictive assumptions, that international trade will bring about equalization in relative and absolute returns to homogeneous factors across nations.

Factor-proportions or **factor-endowment theory** See Heckscher-Ohlin theory.

Financial account It shows the change in U.S. assets abroad and foreign assets in the United States, other than official reserve assets.

Financial inflow An increase in foreign assets in the nation or reduction in the nation's assets a broad.

Financial outflow A decrease in foreign assets in the nation or increase in the nation's assets a broad.

First credit tranche The 25 percent of a nation's quota in the IMF that the nation is required to pay in SDRs or in the currencies of other members selected by the Fund and could then borrow from the Fund almost automatically.

Footloose industries Industries that face neither substantial weight gains nor losses during the production process and thus

tend to locate where the availability of other inputs leads to lowest overall manufacturing costs.

Foreign debt The hundreds of billions of dollars that developing countries owe to commercial banks in developed countries and that they find difficult to repay or even service (i.e., pay interest on).

Foreign exchange futures A forward contract for standardized currency amounts and selected calendar dates traded on an organized market (exchange).

Foreign exchange market The framework for the exchange of one national currency for another.

Foreign exchange options A contract specifying the right to buy or sell a standard amount of a traded currency at or before a stated date.

Foreign exchange risk The risk resulting from changes in exchange rates over time and faced by anyone who expects to make or to receive a payment in a foreign currency at a future date; also called an open position.

Foreign exchange swap The spot sale of a currency combined with a forward repurchase of the same currency—as part of a single transaction.

Foreign repercussions The effect that a change in a large nation's income and trade has on the rest of the world and which the rest of the world in turn has on the nation under consideration. This is how business cycles are transmitted internationally.

Foreign Sales Corporation (FSC) The overseas subsidiaries set up by U.S. corporations to take advantage of partial exemption from U.S. tax laws.

Foreign trade multiplier (k') The ratio of the change in income to the change in exports and/or investment. It equals $k' = 1/(MPS + MPM)$.

Forward discount The percentage per year by which the forward rate on the foreign currency is below its spot rate.

Forward premium The percentage per year by which the forward rate on the foreign currency is above its spot rate.

Forward rate The exchange rate in foreign exchange transactions involving delivery of the foreign exchange one, three, or six months after the contract is agreed upon.

Freely floating exchange rate system The flexible exchange rate system under which the exchange rate is always determined by the forces of demand and supply without any government intervention in foreign exchange markets.

Free trade area Removes all barriers on trade among members, but each nation retains its own barriers on trade with non-members. The best examples are the EFTA, NAFTA, and Mercosur.

Fundamental disequilibrium Large and persistent balance-of-payments deficits or surpluses.

G

Gains from exchange The increase in consumption resulting from exchange alone and with the nation continuing to produce at the autarky point.

Gains from specialization The increase in consumption resulting from specialization in production.

Gains from trade The increase in consumption in each nation resulting from specialization in production and trading.

Game theory A method of choosing the optimal strategy in conflict situations.

- General Agreements on Tariffs and Trade (GATT)** An international organization devoted to the promotion of freer trade through multilateral trade negotiations.
- General Arrangements to Borrow (GAB)** The arrangements under which the IMF negotiated to borrow from the “Group of Ten” (most important industrial nations) and Switzerland to augment its resources if needed to help nations with balance-of-payments difficulties.
- General equilibrium analysis** The study of the interdependence that exists among all markets in the economy.
- General equilibrium model** An economic model that studies the behavior of all producers, consumers, and traders simultaneously.
- Globalization** The increasing integration of economies around the world, particularly through trade and financial flows, but also through the movement of ideas and people, facilitated by the revolution in telecommunication and transportation.
- Gold export point** The mint parity plus the cost of shipping an amount of gold equal to one unit of the foreign currency between the two nations.
- Gold import point** The mint parity minus the cost of shipping an amount of gold equal to one unit of the foreign currency between the two nations.
- Gold standard** The international monetary system operating from about 1880 to 1914 under which gold was the only international reserve, exchange rates fluctuated only within the gold points, and balance-of-payments adjustment was described by the price-specie-flow mechanism.
- Gold tranche** The 25 percent of a nation’s quota in the IMF that the nation was originally required to pay in gold and could then borrow from the Fund almost automatically.
- Gravity model** It postulates that (other things equal) the bilateral trade between two countries is proportional or at least positively related to the product of the two countries’ GDPs, and smaller the greater the distance between the two countries (just like in Newton’s law of gravity in physics).
- Group of Twenty (G-20)** The group of the 20 most important developed and developing economies that essentially replaced the G-7 as the steering committee of the world economy in 2008.

H

- Heckscher–Ohlin (H–O) theorem** The part of the Heckscher–Ohlin theory that postulates that a nation will export the commodity intensive in its relatively abundant and cheap factor and import the commodity intensive in its relatively scarce and expensive factor.
- Heckscher–Ohlin (H–O) theory** The theory that postulates that (1) a nation exports commodities intensive in its relatively abundant and cheap factor and (2) international trade brings about equalization in returns to homogeneous factors across countries.
- Hedging** The avoidance of a foreign exchange risk (or the covering of an open position).
- High-performance Asian economies (HPAEs)** Hong Kong, Korea, Singapore, and Taiwan characterized by rapid growth in gross domestic product (GDP), in industrial production, and in manufactured exports; also called newly industrialized economies (NIEs).
- Homogeneous of degree 1** A production function exhibiting constant returns to scale.
- Horizontal integration** The production abroad of a differentiated product that is also produced at home.
- Human capital** The education, job training, and health embodied in workers, which increase their productivity.
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- Identification problem** The inability of the regression technique to identify shifts in demand curves from shifts in supply curves, leading to the underestimation of price elasticities in empirical studies of international trade.
- IMF conditionality** The conditions imposed by the IMF on members’ borrowings from the Fund.
- Immiserizing growth** The situation where a nation’s terms of trade deteriorate so much as a result of growth that the nation is worse off after growth than before, even if growth without trade tends to improve the nation’s welfare.
- Import function** The positive relationship between the nation’s imports and national income.
- Import substitutes** Commodities (such as automobiles in the United States) that a nation produces at home but also imports from other nations (because of incomplete specialization in production).
- Import-substitution industrialization (ISI)** The industrialization policy that many developing nations followed during the 1950s, 1960s, and 1970s involving the replacement of imports of industrial goods with domestically produced goods.
- Import tariff** A tax or duty on imports.
- Income elasticity of demand for imports (η_y)** The ratio of the percentage change in imports to the percentage change in national income; it is equal to MPM/APM .
- Income terms of trade** The ratio of the price index of the nation’s exports to the price index of its imports times the index of the nation’s volume of exports.
- Incomplete specialization** The continued production of both commodities in both nations with increasing costs, even in a small nation with trade.
- Increasing opportunity costs** The increasing amounts of one commodity that a nation must give up to release just enough resources to produce each additional unit of another commodity. This is reflected in a production frontier that is concave from the origin.
- Increasing returns to scale** The production situation where output grows proportionately more than the increase in inputs or factors of production. For example, doubling all inputs more than doubles output.
- Industrial policy** An activist policy by the government to stimulate the development and growth of some industry (usually a high-tech industry) in an industrial nation.
- Infant-industry argument** The argument that temporary trade protection is needed to set up an industry and to protect it during its infancy against competition from more established and efficient foreign firms.
- Inferior goods** Those goods for which consumption declines absolutely if income rises and increases absolutely if income falls (so that the income elasticity of demand is negative).
- Inflation targeting** The monetary policy of achieving a specific target for inflation for the nation.
- Input–output table** A matrix or table showing the origin and destination of each product in the economy.
- Interdependence** The (economic) relationships among nations.

Interest arbitrage The transfer of short-term liquid funds abroad to earn a higher return.

Internal balance The objective of full employment with price stability; usually a nation's most important economic objective.

Internal factor mobility The movement within a nation of factors of production from areas and industries of lower earnings to areas and industries of higher earnings.

International Bank for Reconstruction and Development (IBRD or World Bank) The international institution established after World War II to provide long-run development assistance to developing nations.

International cartel An organization of suppliers of a commodity located in different nations (or a group of governments) that agrees to restrict output and exports of the commodity with the aim of maximizing or increasing the total profits of the organization. An international cartel that behaves as a monopolist is called a centralized cartel.

International commodity agreements Organizations of producer and consumer nations attempting to stabilize and increase the prices and earnings of the primary exports of developing nations.

International Development Association (IDA) The affiliate of the International Bank for Reconstruction and Development set up in 1960 to make loans at subsidized rates to poorer developing nations.

International economies of scale The increased productivity resulting from the firm's integration of its entire system of manufacturing operations around the world.

International factor mobility The movement of factors of production across national boundaries, usually from nations of lower earnings to nations of higher earnings.

International finance The study of foreign exchange markets, the balance of payments, and adjustment to balance-of-payments disequilibria.

International Finance Corporation (IFC) The affiliate of the International Bank for Reconstruction and Development set up in 1956 to stimulate *private* investments in developing nations from indigenous and foreign sources.

International investment position The total amount and the distribution of a nation's assets abroad and foreign assets in the nation at year-end; also called the balance of international indebtedness.

International macroeconomic policy coordination The modifications of national economic policies in recognition of international interdependence.

International Monetary Fund (IMF) The international institution created under the Bretton Woods system for the purposes of (1) overseeing that nations followed a set of agreed-upon rules of conduct in international trade and finance and (2) providing borrowing facilities for nations in temporary balance-of-payments difficulties.

International monetary system The rules, customs, instruments, facilities, and organizations for effecting international payments.

International Trade Organization (ITO) An international organization that was to regulate international trade after World War II. It was never ratified by the U.S. Senate and never came into existence. Its place was taken by GATT, which was less ambitious.

International trade policy Examines the reasons for and effects of trade restrictions.

International trade theory Analyzes the basis and the gains from trade.

Intervention currency A convertible national currency (primarily the U.S. dollar) used by nations' monetary authorities to intervene in foreign exchange markets in order to keep the exchange rate from moving outside the allowed or desired range of fluctuation.

Intra-industry trade International trade in the differentiated products of the same industry or broad product group.

Intra-industry trade index (T) It is given by 1 minus the ratio of the absolute value of exports minus imports over exports plus imports.

Investment function The relationship between investment expenditures and income. With investment exogenous, the investment function is horizontal when plotted against income. That is, investment expenditures are independent of (or do not change with) the level of national income.

IS curve The negatively inclined curve showing the various combinations of interest rates and national income levels at which the goods market is in equilibrium.

Iso-cost A line showing the various combinations of two inputs that a firm can hire for a given expenditure and factor prices.

Isoquant A curve showing the various combinations of two factors or inputs that a firm can use to produce a specific level of output.

J

Jamaica Accords The agreements reached in January 1976 and ratified in April 1978 that recognized the managed float and abolished the official price of gold.

J-curve effect The deterioration before a net improvement in a country's trade balance resulting from a depreciation or devaluation.

K

Kennedy Round The multilateral trade negotiations that were completed in 1967 (under the authority of the 1962 Trade Expansion Act) under which agreement was reached to reduce average tariff duties on industrial products by 35 percent.

L

Labor-capital ratio (L/K) The amount of labor per unit of capital used in the production of a commodity.

Labor-intensive commodity The commodity with the higher labor-capital ratio (L/K) at all relative factor prices.

Labor-saving technical progress Technical progress that increases the productivity of capital proportionately more than the productivity of labor and results in an increase in K/L at constant relative factor prices.

Labor theory of value The theory that the cost or price of a commodity is determined by or can be inferred exclusively from its labor content.

Laissez-faire The policy of minimum government interference in or regulation of economic activity, advocated by Adam Smith and other classical economists.

Law of comparative advantage Explains how mutually beneficial trade can take place even when one nation is less efficient than, or has an absolute disadvantage with respect to, another nation in the production of all commodities. The less efficient nation should specialize in and export the commodity in

which its absolute disadvantage is smaller (this is the commodity of its comparative advantage), and should import the other commodity.

Law of one price The proposition that in the absence of transportation costs, tariffs, and other obstructions to the free flow of trade, the price of each homogeneous (identical) traded commodity will be equalized in all markets by commodity arbitrage.

Law of reciprocal demand The equilibrium relative commodity price with trade determined at the intersection of the nations' reciprocal demand or offer curves.

Leaning against the wind The policy of monetary authorities supplying part of the excess demand or absorbing part of the excess supply of foreign exchange in the market to smooth out short-run fluctuations in exchange rates.

Learning curve The curve showing the degree by which average costs of production decline as cumulative industry output increases over time.

Leontief paradox The empirical finding that U.S. import substitutes were more K intensive than U.S. exports. This is contrary to the H-O trade model, which predicts that, as the most K -abundant nation, the United States should import L -intensive products and export K -intensive products.

Liquidity The amount of international reserve assets available to nations to settle temporary balance-of-payments disequilibria.

LM curve The usually positively inclined curve showing the various combinations of interest rates and national income levels at which the money market is in equilibrium.

Long-run aggregate supply (LRAS) curve The fixed relationship between the nation's price level and its natural level of output, which depends on the availability of labor, capital, natural resources, and technology in the nation.

M

Maastricht Treaty The treaty that called for the creation of the European Monetary Institute as a forerunner of the European Central Bank and monetary union by the European Union by 1997 or 1999.

Macroeconomics The study of the whole or the aggregate, such as the total receipts and payments of a nation and the general price index.

Managed floating exchange rate system The policy of intervention in foreign exchange markets by monetary authorities to smooth out short-run fluctuations without attempting to affect the long-run trend in exchange rates.

Marginal propensity to consume (MPC) The ratio of the change in consumption expenditures to the change in income, or $\Delta C/\Delta Y$.

Marginal propensity to import (MPM) The ratio of the change in imports to the change in national income, or $\Delta M/\Delta Y$.

Marginal propensity to save (MPS) The ratio of the change in saving to the change in income, or $\Delta S/\Delta Y$.

Marginal rate of substitution (MRS) The amount of one commodity that a nation could give up in exchange for one extra unit of a second commodity and still remain on the same indifference curve. It is given by the slope of the community indifference curve at the point of consumption and declines as the nation consumes more of the second commodity.

Marginal rate of technical substitution of labor for capital in production (MRTS) It shows how much capital a firm can give up by increasing labor by one unit and still remain on the same isoquant.

Marginal rate of transformation (MRT) The amount of one commodity that a nation must give up to produce each additional unit of another commodity. This is another name for the opportunity cost of a commodity and is given by the slope of the production frontier at the point of production.

Market-oriented industries Industries that produce goods that become heavier or more difficult to transport during production and thus locate near the markets for the product.

Marketing boards National schemes set up by several developing nations after World War II to stabilize export prices for individual producers of an agricultural commodity.

Marshall-Lerner condition Indicates that the foreign exchange market is stable when the sum of the price elasticities of the *demands* for imports and exports is larger than 1 (when the *supply* elasticities of imports and exports are infinite).

Mercantilism The body of writings prevailing during the seventeenth and eighteenth centuries that postulated that the way for a nation to become richer was to restrict imports and stimulate exports. Thus, one nation could gain only at the expense of other nations.

Mercosur The South American, or Southern Cone, Common Market that was formed by Argentina, Brazil, Paraguay, and Uruguay in 1991.

Metzler paradox The exception to the Stolper-Samuelson theorem.

Microeconomics The study of individual units, such as a particular nation and the relative price of a single commodity.

Mint parity The fixed exchange rates resulting under the gold standard from each nation defining the gold content of its currency and passively standing ready to buy or sell any amount of gold at that price.

Monetary approach to the balance of payments The approach that views the balance of payments as an essentially monetary phenomenon with money playing the key role in the long run as both the cause and the cure of balance-of-payments disequilibria or in determining exchange rates.

Monetary base The domestic credit created by the nation's monetary authorities plus the nation's international reserves.

Monopolistic competition The form of market organization where there are many firms selling a differentiated product and entry into or exit from the industry is relatively easy.

Monopoly The form of market organization where there is a single producer of a commodity for which there is no close substitute.

Most-favored-nation principle The extension to all trade partners of any reciprocal tariff reduction negotiated by the United States with any other nation.

Multilateral trade negotiations Trade negotiations among many nations.

Multinational corporations (MNCs) Firms that own, control, or manage production and distribution facilities in several countries.

Multiple exchange rates The different exchange rates often enforced by developing nations for each class of imports depending on the usefulness of the various imports as determined by the government.

Multiplier (k) The ratio of the change in income to the change in investment; in a closed economy without government, $k = 1/MPIS$.

Mundell–Fleming model The model that shows how a nation can use fiscal and monetary policies to achieve both internal and external balance without any change in the exchange rate.

N

National security clause A protectionist device that prevented any tariff reduction (even if already negotiated) that would hurt industries important for national defense.

Natural level of output (Y_N) The fixed level of output that a nation can produce in the long run with its given quantity of labor, capital, natural resources, and technology.

Net IMF position The size of a nation's quota in the IMF minus the Fund's holdings of the nation's currency.

Neutral production and consumption Increases in production and consumption that lead to proportionate increases in the volume of trade.

Neutral technical progress Technical progress that increases the productivity of labor and capital in the same proportion and leaves K/L constant at constant relative factor prices.

New Arrangement to Borrow (NAB) The arrangement negotiated by the International Monetary Fund at the beginning of 1997 under which 25 participant countries and institutions agreed to lend up to SDR34 billion (about \$47 billion) to supplement the General Arrangements to Borrow (GAB) for a period of five years (subject to renewal).

New International Economic Order (NIEO) The demands made by developing nations as a group at the United Nations for the removal of the alleged inequities in the operation of the present international economic system and for specific steps to be taken to facilitate their development.

New protectionism New forms of nontariff trade barriers.

Newly Independent States (NIS) Includes Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

Newly industrialized economies (NIEs) Hong Kong, Korea, Singapore, and Taiwan characterized by rapid growth in gross domestic product (GDP), in industrial production, and in manufactured exports; also called high-performance Asian economies (HPAEs).

Nominal tariff A tariff (such as an ad valorem one) calculated on the price of a final commodity.

Nontariff trade barriers (NTBs) Trade restrictions other than tariffs, such as voluntary export restraints; technical, administrative, and other regulations; as well as those arising from international cartels, dumping, and export subsidies.

Nontraded goods and services Those goods and services that are not traded internationally because the cost of transporting them exceeds the international price difference.

Normal goods Those goods for which consumption changes in the same direction as a change in income (so that the income elasticity of demand is positive).

North American Free Trade Agreement (NAFTA) The agreement to establish a free trade area among the United States, Canada, and Mexico that came into existence on January 1, 1994.

O

Offer curve A curve that shows how much of its import commodity a nation demands to be willing to supply various amounts of its export commodity, or the willingness of the nation to import and export at various relative commodity prices.

Official reserve account It measures the change in U.S. official reserve assets and the change in foreign official reserve assets in the United States.

Official settlements balance The net credit or debit balance in the official reserve account.

Offshore deposits Bank deposits denominated in a currency other than that of the nation in which the deposit is held.

Offshoring It refers to a firm producing products in its own plant abroad and some of the parts and components that it uses in its products produced at home.

Oligopoly The form of market organization where there are only a few producers of a homogeneous or differentiated product.

Omnibus Trade and Competitiveness Act of 1988 Through its Super 301 provision, the Act requires curbing imports from countries that do not remove major barriers to the U.S. exports.

Open-economy macroeconomics The study of foreign exchange markets, the balance of payments, and adjustment to balance-of-payments disequilibria.

Opportunity cost theory The theory that the cost of a commodity is the amount of a second commodity that must be given up to release just enough resources to produce one more unit of the first commodity.

Optimum currency area or bloc Refers to a group of nations whose national currencies are linked through permanently fixed exchange rates and the conditions that would make such an area optimum.

Optimum tariff The rate of tariff that maximizes the benefit resulting from improvement in the nation's terms of trade against the negative effect resulting from reduction in the volume of trade.

Original sin The inability of a developing country to borrow in its own currency.

Outsourcing The firm's purchase of parts and components abroad to keep costs down in a globalizing world.

P

Partial equilibrium analysis The study of individual decisionmaking units (such as a firm or nation) in isolation (i.e., abstracting from all the interconnections that exist between the firm or nation and the rest of the economy or world).

Pass-through effect The proportion of an exchange rate change that is reflected in export and import price changes.

Pattern of trade The commodities exported and imported by each nation.

Perfect competition The market condition where (1) there are many buyers and sellers of a given commodity or factor, each too small to affect the price of the commodity or factor; (2) all units of the same commodity or factor are homogeneous, or of the same quality; (3) there is perfect knowledge and information on all markets; and (4) there is perfect internal mobility of factors of production.

Peril-point provisions A protectionist device that prevented the president from negotiating any tariff reduction that would cause serious damage to a domestic industry.

Persistent dumping The *continuous* tendency of a domestic monopolist to maximize total profits by selling the commodity at a lower price abroad than domestically; also called international price discrimination.

Phillips curve The controversial inverse relationship, or trade-off, between unemployment and inflation.

Portfolio balance approach The theory that postulates that exchange rates are determined in the process of equilibrating or balancing the demand and supply of financial assets in each country.

Portfolio investments The purchase of purely financial assets, such as bonds and stocks (if the stock purchase represents less than 10 percent of the stock of a corporation), usually arranged through banks and investment funds.

Portfolio theory Maintains that by investing in securities with yields that are inversely related over time, a given yield can be obtained at a smaller risk or a higher yield can be obtained at the same level of risk for the portfolio as a whole.

Predatory dumping The *temporary* sale of commodity at a lower price abroad in order to drive foreign producers out of business, after which prices are raised to take advantage of the newly acquired monopoly power abroad.

Preferential trade arrangements The loosest form of economic integration; provides lower barriers to trade among participating nations than on trade with nonparticipating nations. An example is the British Commonwealth Preference Scheme.

Price-specie-flow mechanism The automatic adjustment mechanism under the gold standard. It operates by the deficit nation losing gold and experiencing a reduction in its money supply. This in turn reduces domestic prices, which stimulates the nation's exports and discourages its imports until the deficit is eliminated. A surplus is corrected by the opposite process.

Principle of effective market classification Maintains that policy instruments should be paired or used for the objective toward which they are most effective.

Product cycle model The hypothesis, advanced by Vernon, that new products introduced by industrial nations and produced with skilled labor eventually become standardized and can be produced in other nations with less skilled labor.

Production contract curve The curve joining points at which the isoquants of two commodities are tangent and factor inputs are used most efficiently.

Production effect of a tariff The increase in domestic production of a commodity resulting from the increase in its price due to a tariff.

Production function A relationship showing the maximum quantities of a commodity that a firm can produce with various amounts of factor inputs.

Production possibility frontier A curve showing the various alternative combinations of two commodities that a nation can produce by fully utilizing all of its resources with the best technology available to it.

Prohibitive tariff A tariff sufficiently high to stop all international trade so that the nation returns to autarky.

Protection cost or deadweight loss of a tariff The real losses in a nation's welfare because of inefficiencies in production and distortions in consumption resulting from a tariff.

Protrade production and consumption Increases in production and consumption that lead to greater than proportionate increases in the volume of trade.

Purchase contracts Long-term multilateral agreements that stipulate the minimum price at which importing nations agree to purchase a specified quantity of the commodity and a maximum price at which exporting nations agree to sell specified amounts of the commodity.

Purchasing-power parity (PPP) theory The theory that postulates that the change in the exchange rate between two currencies is proportional to the change in the ratio in the two countries' general price levels.

Q

Quantity theory of money Postulates that the nation's money supply times the velocity of circulation of money is equal to the nation's general price index times physical output at full employment. With V and Q assumed constant, the change in P is directly proportional to the change in M .

Quota A direct *quantitative* restriction on trade.

R

Rate of effective protection The tariff calculated on the domestic value added in the production of a commodity.

Real exchange rate The nominal exchange rate weighed by the consumer price index in the two nations.

Reciprocal demand curve Another name for the offer curve.

Regions of recent settlement The mostly empty and resource-rich lands that Europeans settled during the nineteenth century, such as the United States, Canada, Argentina, Uruguay, Australia, New Zealand, and South Africa.

Relative commodity prices The price of one commodity divided by the price of another commodity. This equals the opportunity cost of the first commodity and is given by the absolute slope of the production possibility frontier.

Relative factor prices The ratio of the price of one factor of production to the price of the other factor. With labor and capital as the factors of production, the relative price of labor is w/r and the relative price of capital is the inverse, or r/w .

Relative purchasing-power parity theory Postulates that the change in the exchange rate over a period of time should be proportional to the relative change in the price levels in the two nations. This version of the PPP theory has some value.

Renminbi or yuan The currency of china.

Rent or producer surplus A payment that need not be made in the long run in order to induce producers to supply a specific amount of a commodity or factor services.

Reserve-currency country (RCC) A country, such as the United States, whose currency is held by other nations as international reserves.

Resource-oriented industries Industries which process bulky and heavy raw materials into lighter finished products and thus locate near raw material sources.

Revenue effect of a tariff The revenue collected by the government from the tariff.

Risk diversification Investments in securities with yields that are inversely, or negatively, correlated or investments in different lines or products in order to spread and thus reduce the overall risks of the total investments.

Risk premium The extra return that investors require to purchase or hold on to foreign bonds to compensate them for the additional currency and country risks involved in holding foreign bonds.

Roosa bonds Medium-term treasury bonds denominated in dollars but with an exchange rate guarantee, created by the United States in the early 1960s to induce foreign monetary authorities to continue to hold dollars rather than exchange them for gold at the Federal Reserve.

Rules of the game of the gold standard The requirement under the gold standard that monetary authorities restrict credit in the deficit nation and expand credit in the surplus nation (thus reinforcing the effect of changes in international gold flows on the nation's money supply).

Rybczynski theorem Postulates that at constant commodity prices, an increase in the endowment of one factor will increase by a greater proportion the output of the commodity intensive in that factor and will reduce the output of the other commodity.

S

Same technology Equal production techniques; it results in equal K/L in the production of each commodity in both nations if relative factor prices are the same in both nations.

Saving function The relationship between saving and income. In general, saving is negative when income is zero and rises as income rises, in such a way that the increase in consumption plus the increase in saving equals the increase in income.

Scientific tariff The tariff rate that would make the price of imports equal to domestic prices so as to allow domestic producers to meet foreign competition.

Seigniorage The benefit accruing to a nation from issuing the currency or when its currency is used as an international currency and reserve.

Shared Foreign Sales Corporations U.S. tax legislation aimed at stimulating U.S. exports by reducing the effective rate of taxation on export income.

Short-run aggregate supply (SRAS) curve The temporary positive relationship between the nation's output and the price level resulting from imperfect information or market imperfections.

Single factoral terms of trade The ratio of the price index of the nation's exports to the price index of its imports times the productivity index in the nation's export sector.

Small-country case The situation where trade takes place at the pretrade relative commodity prices in the large nation so that the small nation receives all of the benefits from trade.

Smithsonian Agreement The agreement reached in December 1971 in Washington under which the dollar was devalued by about 9 percent (by increasing the dollar price of gold from \$35 to \$38 an ounce), other strong currencies were revalued by various amounts with respect to the dollar, the dollar convertibility into gold remained suspended, and exchange rates were allowed to fluctuate by 2.25 percent on either side of the new par values.

Smoot-Hawley Tariff Act of 1930 Raised average import duties in the United States to the all-time high of 59 percent in 1932.

Southern Common Market (see Mercosur)

Special Drawing Rights (SDRs) International reserves created by the IMF to supplement other international reserves and distributed to member nations according to their quotas in the Fund.

Specific-factors model The model to analyze the effect of a change in commodity price on the returns of factors in a nation when at least one factor is not mobile between industries.

Specific tariff A tariff expressed as a fixed *sum* per unit of a traded commodity.

Speculation The acceptance of a foreign exchange risk, or open position, in the hope of making a profit.

Speculative demand for money The demand for inactive money balances in preference to interest-bearing securities (which can fall in price) so that one may take advantage of future investment opportunities. The speculative, or liquidity, demand for money varies inversely with the rate of interest.

Spurious dumping The *occasional* sale of a commodity at a lower price abroad than domestically in order to sell an unforeseen and temporary surplus of the commodity abroad without having to reduce domestic prices.

Spot rate The exchange rate in foreign exchange transactions that calls for the payment and receipt of the foreign exchange within two business days from the date when the transaction is agreed upon.

Stability and Growth Pact (SGP) The pact that requires members of the European Monetary Union to keep their budget deficits not exceeding 3 percent of their GDP.

Stabilizing speculation The purchase of a foreign currency when the domestic currency price of the currency (i.e., the exchange rate) falls or is low, in the expectation that the exchange rate will soon rise, thus leading to a profit. Or the sale of a foreign currency when the exchange rate rises or is high, in the expectation that it will soon fall.

Stable foreign exchange market The condition in a foreign exchange market where a disturbance from the equilibrium exchange rate gives rise to automatic forces that push the exchange rate back toward the equilibrium rate.

Stagflation The combination of recession or stagnation and increasing prices or inflation.

Standby arrangements The arrangements under which member nations negotiate with the IMF for advance approval for future borrowings from the Fund so they will be immediately available when needed.

State trading companies The state organizations in centrally planned economies handling trade in specific product lines.

Statistical discrepancy The entry made in a nation's balance of payments to make total credits equal to total debits, as required by double-entry bookkeeping.

Stolper-Samuelson theorem Postulates that an increase in the relative price of a commodity (for example, as a result of a tariff) raises the return or earnings of the factor used intensively in the production of the commodity.

Strategic trade policy The argument that an activist trade policy in oligopolistic markets subject to extensive external economies can increase a nation's welfare.

Subprime mortgage crisis The financial crisis that started in the U.S. housing market and then spread to the entire financial and economic sectors of the United States and the world.

Substitution account The account proposed to be used to exchange all foreign-held dollars for SDRs at the IMF to solve the problem of the dollar overhang.

Super gold tranche The amount by which the IMF's holdings of a nation's currency are below 75 percent of the nation's quota, which the nation could borrow from the Fund without the need to repay.

Supply of money The nation's total money supply is equal to the nation's monetary base times the money multiplier.

Surplus in the balance of payments The excess of credits over debits in the current and capital accounts, or autonomous transactions; equal to the net *debit* balance in the official reserve account, or accommodating transactions.

Swap arrangements The arrangements under which national central banks negotiate to exchange each other's currency to be used to intervene in foreign exchange markets to combat international hot money flows.

Synthesis of automatic adjustments The attempt to integrate the automatic price, income, and monetary adjustments to correct balance-of-payments disequilibria.

T

Tariff factories Direct investments made in a nation or other economic unit (such as a customs union) to avoid import tariffs.

Technical, administrative, and other regulations Nontariff trade barriers such as safety, health, and labeling requirements, and border taxes.

Technological gap model The hypothesis that a portion of international trade is based on the introduction of new products or processes.

Terms of trade The ratio of the index price of a nation's export to its import commodities.

Terms-of-trade effect The change in the relative commodity prices at which a nation trades; it results from the tendency of the volume of trade to change as the nation grows.

Theory of the second best Postulates that when all of the conditions required to reach maximum social welfare or Pareto optimum cannot be satisfied, trying to satisfy as many of these conditions as possible does not necessarily or usually lead to the second-best welfare position.

Tokyo Round The multilateral trade negotiations that were completed in 1979 (under the authority of the 1974 Trade Reform Act) in which agreement was reached to cut average tariff rates by about 30 percent and to adopt a uniform international code of conduct for applying nontariff trade barriers.

Trade Adjustment Assistance The provision of the Trade Expansion Act of 1962 (and continued in subsequent Trade Acts), which provides to assist displaced workers and firms injured by trade liberalization.

Trade Agreements Act of 1934 Authorized the President to negotiate with other nations mutual tariff reductions of up to 50 percent under the most-favored-nation principle.

Trade controls Tariffs, quotas, advance deposits on imports, and other restrictions imposed by a nation on international trade.

Trade-creating customs union A customs union that leads to trade creation only and increases the welfare of both member and nonmember nations.

Trade creation Occurs when some domestic production in a member of the customs union is replaced by lower-cost imports from another member nation. This increases welfare.

Trade deflection The entry of imports from the rest of the world into the low-tariff member of a free trade area to avoid the higher tariffs of other members.

Trade diversion Occurs when lower-cost imports from outside the union are replaced by higher-cost imports from another union member. By itself, this reduces welfare.

Trade-diverting customs union A customs union that leads to both trade creation and trade diversion and may increase or reduce the welfare of member nations, depending on the relative strength of these two opposing forces.

Trade effect of a tariff The reduction in the volume of trade in the commodity resulting from a tariff.

Trade Expansion Act of 1962 Granted the President authority to negotiate across-the-board tariff reductions of up to 50 percent of their 1962 level and replaced the no-injury principle with adjustment assistance.

Trade indifference curve The curve showing the various trade situations that provide a nation equal welfare.

Trade or elasticities approach The theory or approach that stresses the role of trade or the flow of goods and services in the determination of exchange rates. This model is more useful in explaining exchange rates in the long run than in the short run.

Trade or commercial policies The regulations governing a nation's commerce or international trade.

Trade promotion authority or "fast track" Legislation granting to the president of the United States the right to negotiate global trade agreements with other nations that allowed no amendments, but only an up-or-down vote by Congress to ratify or reject the agreement (Sect. 9.7A).

Trade Reform Act of 1974 Granted the President authority to negotiate tariff reductions of up to 60 percent of their post-Kennedy Round level and to negotiate reductions in nontariff trade barriers.

Trade and Tariff Act of 1984 Authorized the President to negotiate the lowering of trade barriers in services and a free trade agreement with Israel, and extended the Generalized System of Preferences (GSP) until 1993.

Transaction demand for money The demand for active money balances to carry on business transactions; it varies directly with the level of national income and the volume of business transactions.

Transfer pricing The overpricing or underpricing of products in the intrafirm trade of multinational corporations in an attempt to shift income and profits from high- to low-tax nations.

Transfer problem Deals with the conditions under which a large and unusual capital transfer is actually accomplished by an export surplus of the paying nation and an equal import surplus of the receiving nation.

Transport or logistics costs Freight charges, warehousing costs, costs of loading and unloading, insurance premiums, and interest charges while goods are in transit (Sect. 6.6).

Trigger-price mechanism The antidumping mechanism introduced by the United States in 1978 to protect its steel industry by imposing a duty on underpriced imported steel to make its price equal to that of the lowest cost foreign producer.

Trilemma The policy dilemma of a nation being able to achieve only two of three policy choices: a fixed exchange rate system, unrestricted international finance flows, and monetary policy autonomy.

U

Uncovered interest arbitrage The transfer of short-term liquid funds to the international monetary center with higher interest rates without covering the foreign exchange risk.

Unilateral transfers Gifts or grants extended to or received from abroad.

United Nations Conferences on Trade and Development (UNCTAD) Special conferences held under the auspices of the United Nations in 1964, 1968, 1972, 1976, 1979, 1983, 1987, and 1992 at which developing nations advanced their demands to improve the operation of the present international economic system to facilitate their development.

Unstable foreign exchange market The condition in a foreign exchange market where a disturbance from equilibrium pushes the exchange rate farther away from equilibrium.

Uruguay Round The multilateral trade negotiations started in 1986 and completed at the end of 1993 aimed at reversing the trend of rising nontariff trade barriers. It replaced the GATT with the World Trade Organization (WTO), brought services and agriculture into the WTO, and improved the dispute settlement mechanism.

V

Variable import levies The import duties levied by the EU on imports of agricultural commodities and equal to the difference between the high farm prices established by the EU and the lower world prices.

Vehicle currency A currency such as the U.S. dollar used to denominate international contracts and for international transactions.

Vent for surplus The view that exports could be an outlet for the potential surplus of agricultural commodities and raw materials in some developing countries.

Vertical integration The expansion of a firm backward to supply its own raw materials and intermediate products and/or forward to provide its own sales or distribution networks.

Voluntary export restraints (VERs) Refer to an importing country inducing another country to “voluntarily” reduce its exports of a commodity to the importing nation under the threat of higher all-around trade restrictions.

W

Wealth effect The change in the output per worker or per person as a result of growth in the nation.

World Trade Organization (WTO) The organization set up at the Uruguay Round to replace the General Agreement on Tariffs and Trade (GATT) secretariat with authority over trade in industrial goods, agricultural commodities, and services, and with greater authority to settle trade disputes.

Y

Yuan or renminbi The currency of China.