Glossary

Access pricing A charges for access to a service.
Accrual accounting Expenses and income are recorded when they occur, not when they are paid.
Ad valorem tax A tax on the value of sales.
Additive utilitarian social welfare function Social welfare expressed as the sum of individuals’ utilities.
Adverse selection A problem in insurance markets that occurs because those taking up insurance contracts are likely to be worse risks than those who do not take up insurance.
Allocative efficiency Allocating resources so as to produce the optimal mix of goods.
Arrow’s Impossibility Theorem No collective decision-making rule compiles fully with six generally accepted ethical criteria for voting.
Asymmetric information A situation in which economic agents do not have the same information.
Benchmarking Comparing an agency’s costs with the costs of similar providers.
Benefit-cost ratio The ratio of the present value of net recurrent benefits to the present value of capital expenditure.
Black economy Unreported commercial transactions that do not enter into gross domestic product calculations.
Budget constraint The limit to expenditure.
Budget sector Government services that are financed out of the annual government budget.
Capital gain An increase in the value of an asset.
Capitalisation The process whereby future income or payments are incorporated into the price of an asset.
Categorical income transfer A payment that depends on the recipient belonging to a specified category of person.
Certainty equivalent The amount of income that an individual would give up in exchange for an uncertain prospect.
Coase theorem Private actions will correct for externalities.
Common property resources Non-excludable resources available freely to anyone who wants to use them.
Comparative advantage Exists when the opportunity cost of production of a good (in terms of other goods forgone) is lower in one country than in another. The concept applies generally to all economic agents.
Compensated demand The demand for goods as a function of price, while holding utility constant.
Compensated labour supply The supply of labour as a function of wages when the income effect of wage changes is removed.
Compensating variation The amount of money that ensures an individual is as well off with a change as he or she is without it.
Computable general equilibrium model A model with equations for demand and supply for all sectors of the economy.
Concentration ratio A measure of the proportion of a market taken up by the largest firms in it.
Consolidated revenue The government account into which all taxes are paid unless they are ear-marked for a special purpose.
Constitution Defines the basic institutions and rules of the state and the methods of appointment and powers of the head of state and government.
Constant prices A common set of prices used to value economic variables at different points in time.
Consumer surplus The difference between the maximum amount that a consumer is willing to pay for a good and the amount that he or she actually pays.
Contestable market A market in which entry and exit are free.
Contingent valuation A survey method used to elicit individual values for a non-market good, contingent on it being available.
Corrective tax A tax that corrects for market failure by adjusting the marginal private cost of a good to internalise a negative externality.
Cost-benefit analysis An evaluation method that compares the total social costs and benefits of a proposal as far as possible in money terms.
Cost-effective analysis A technique for comparing the costs of alternative proposals to find the minimum cost solution which achieves the given objective.
Cost function A function relating total cost to the level of output.

Cross-sectional data Data for individuals, firms, regions or countries at a given point in time.

Current prices Using the prices prevailing or forecast for each point in time to measure economic magnitudes at that time.

Deadweight loss A loss for which there is no offsetting benefit.

Depreciation The loss of value of a capital asset in any given period.

Destination taxes Income or consumption is taxed where received or consumed at point of destination.

Direct democracy A public choice in which all adult citizens are entitled to participate by voting.

Direct tax A tax that is borne by the entity paying the tax.

Discount rate The interest rate used to discount future sums to present sums.

Earned income tax credit A tax credit per dollar of earned income.

Economic incidence of taxation Indicates who actually bears the tax.

Economic (pure) profit The excess of a firm’s revenue over the opportunity cost of all inputs. cf: accounting profit which is the return on equity invested.

Economic rent The return to any factor of production in excess of its opportunity cost. For a firm, economic rent is the same as economic profit.

Effective tax rate Actual taxes paid divided by the taxable base.

Effective marginal tax rate The percentage of an extra dollar that an individual loses due to tax and loss of grants.

Elasticity The percentage change in one variable brought about by a one per cent change in another variable.

Elasticity of (technical) substitution A measure of the responsiveness of input combinations, such as labour and capital, to changes in their relative prices, holding output constant.

Equal marginal sacrifice rule Tax should be arranged so that all persons paying tax have an equal marginal sacrifice.

Equilibrium Occurs when no economic agent has an incentive to change their behaviour.

Equity When used in welfare economics, a term that is synonymous with fairness.

Equivalent taxes Two or more sets of taxes with the same incidence.
Horizontal fiscal imbalance. Occurs when sub-national governments have unequal fiscal capacity to provide public services.

Horizontal tax competition. Tax competition between two jurisdictions to attract or retain resources.

Human capital model. An individual invests in education to increase the present value of their lifetime income.

Imperfect competition. Occurs when an individual buyer or seller can influence the market price.

Imputed rent. The monetary value of services that an owner of an asset receives from use of the asset, for example from owner-occupation of a dwelling.

Income (Haig-Simons definition). The value of goods that can be consumed in any period without any change in net wealth.

Income effect. The change in consumption due to a change in real income.

Income in-kind. Income in the form of goods and services rather than cash payments.

Indexation. The use of an index, such as the consumer price index, to adjust nominal prices and maintain constant real values.

Indifference curve. The set of consumption bundles that yields the same total utility to an individual.

Indirect tax. A tax levies on one party that may be borne by another party.

Inflation tax. The effect of inflation on the value of an individual’s monetary assets.

Internal rate of return. The rate of return that equates discounted net benefits to discounted capital costs.

Internalisation. Where the marginal private benefit, or cost, of goods is adjusted so that the users consider the actual marginal social benefit or cost of their decisions.

Intransitivity. Inconsistent rankings of preferences.

Isoquant. A curve which shows the different combinations of inputs that produce a given quantity of output.

Labour intensive. A firm or industry in which the ratio of labour to capital inputs is relatively high.

Linear tax structure. A tax structure that has a constant marginal tax rate at all levels of income.

Local public good. A public good that provides benefits to residents in a local geographical area.

Logrolling. The trading of votes to obtain passage of a package of legislative proposals.

Long run marginal cost. The cost of supplying an additional unit of output in the long run.

Lorenz curve. A curve that plots the proportion of total income received against the proportion of the adult population or income recipients from the poorest to richest.

Low income tax offset. An increase in the threshold at which low earners are taxed.

Lump sum tax. A tax that is independent of an individual’s behaviour.

Marginal. Additional, extra, incremental.

Marginal cost. The incremental cost of producing one more unit of output.

Marginal physical product. The addition to output in physical units per unit increase in any factor input.

Marginal rate of substitution. The rate at which an individual is willing to trade one good for another while remaining equally well off.

Marginal rate of transformation. The amount by which output of one good can be increased if the output of another good is reduced by a small amount.

Marginal revenue. The additional revenue obtained with the sale of one more unit of output.

Marginal revenue product. The addition to revenue from a unit increase in factor input.

Marginal social benefit. The benefit accruing to all parties from production of an extra unit of a good.

Marginal social cost. The cost accruing to all parties from production of an extra unit of a good.

Marginal tax rate. The extra tax paid expressed as a percentage of an additional dollar value of the tax base.

Marginal wage cost. The cost of employing an extra worker.

Mark-up pricing. Prices are marked up until revenues are sufficient to cover costs.

Market disequilibrium. A situation in which the plans of buyers and sellers do not match and some economic agents have an incentive to alter their behaviour.

Market failure. Occurs when a market fails to generate an efficient outcome.

Market power. When a firm can raise price above long-run average cost and obtain a return in excess of competitive rates of return.

Matching grants. Grants that are conditional on the recipient providing a specified contribution.

Median voter. The voter whose preferences lie in the middle of the set of all voters’ preferences.

Median voter theorem. In some specified conditions, the preference of the median voter is decisive.

Merit goods. Goods that government considers individuals should consume even if they do not demand them.

Minimum wage regulation. Regulation that sets the minimum wage at which firms can employ labor.
Mixed public goods Goods with some private good and some public good characteristics.

Moral hazard Occurs when insurance against the consequences of risk changes an individual’s behaviour.

Multi-criteria analysis An evaluation method in which weights are attached to various objectives, and to how well these objectives are met, in order to assess the relative merits of alternative projects.

Natural monopoly A single firm that can supply a market’s total output at lower unit cost than two or more firms can.

Negative gearing Occurs when the interest payment on a property loan creates a negative net income from the property.

Negative income tax system A tax system that includes income grants as well as taxes.

Net present value The estimated value of a stream of benefits net of costs discounted to present value terms.

Net public debt Financial liabilities of government less financial assets.

Net operating budget Current operating revenue minus current expenses.

Net public worth The value of all publicly-owned assets less liabilities at any point in time.

Nominal interest rates Market interest rates inclusive of allowance for inflation.

Non–categorical income transfer A payment that depends only on the income of the recipient and not on whether the recipient belongs to a particular category.

Non-excludable good Individuals cannot be excluded from consuming the good.

Non-linear pricing Where consumers are charged different prices per unit of consumption depending on their level of consumption.

Non-linear tax structure A tax structure which has varying marginal tax rates.

Non-rival good A good is non-rival in consumption when consumption by one individual does not reduce the availability of the good to others.

Normative economics Economic analysis that requires a value judgement.

Numeraire A standard unit of measure used to make comparisons.

Observational studies Studies based on data from observed economic behaviour

Opportunity cost The value of output or leisure foregone by using a resource, or by behaving, in one way rather than another.

Opportunity set The set of outcomes that can be achieved.

Ordinal preferences Rankings or orderings of alternatives.

Ordinary (or observed) demand curve A demand curve that shows how demand varies with price.

Pareto efficient An allocation of resources such that a reallocation cannot make anyone better off without making someone else worse off.

Pareto improvement A reallocation of resources that makes at least one person better off and no one worse off.

Partial equilibrium A model of a single market that ignores possible spillover effects into other markets.

Partial factor tax A tax that is levied on a factor in only some of its uses.

Participation ratio The ratio of the number of persons in the workforce to the number of persons aged 15-64.

Payroll tax A tax levied on the value of wages and salaries paid by employers to employees.

Pecuniary externalities Actions that impact on third parties which are transmitted through the price mechanism.

Perfect competition Where there are a large number of buyers and sellers in the market for any good and each agent is a price taker.

Pigouvian tax A tax levied on each unit of a polluter’s output in an amount equal to the marginal damage that it inflicts at the efficient level of pollution.

Point utility possibilities frontier The utilities obtained from alternative distributions of one basket of goods.

Positive economics Economic analysis of how an economy actually functions

Poverty line The level of income required for a minimally adequate standard of living.

Predatory pricing Occurs when a firm underprices a product with the object of limiting competition.

Present value The capital value now of outcomes occurring in the future.

Price discrimination Occurs when a seller can separate markets and charge different prices for the same product in the separate markets.

Price taker An agent unable to affect the price of a good.

Principle-agent problem Occurs when an agent pursues his own interests at the expense of the principal.

Private good A good that is excludable and rival in consumption.

Private time preference rate The rate at which an individual is willing to trade present for future consumption.
Privatisation Occurs when ownership of assets changes from the public to the private sector.

Producer surplus The difference between the price that a producer receives and production cost.

Product (output) mix efficiency Occurs when an economy produces the mix of goods that individuals most want. A necessary condition is that the marginal rate of transformation equals the marginal rates of substitution of consumers.

Production function An equation that shows the relationship between a firm’s output and its inputs.

Production possibilities frontier The maximum quantity of goods that can be produced with given resources and technology.

Productive (technical) efficiency Producing a given output of goods with minimum use of resource (or producing maximum output from given resources).

Progressive tax system A tax system where the average tax rate rises as the tax base increases.

Property right An entitlement defining the owner’s rights and limitations for use of a resource, including the power to exclude others from using the resource.

Proportional tax system A tax system in which the average tax rate is the same for all values of the tax base.

Public choice theory Uses methods of economic analysis to analyse public choices.

Public good A good that is non-excludable and non-rival in consumption.

Public sector Includes the budget sector and public trading enterprises.

Purchaser–provider split Occurs when delivery of a program is separated from its funding.

Quasi experimental studies Studies that draw on observational data where external or natural events randomly assign individuals to different groups.

Rate of return regulation Regulation of prices based on a rate of return that a regulator allows firms to make.

Real income Income measured in constant prices.

Real interest rates Nominal interest rate corrected for changes in the level of prices.

Regressive tax system A tax system where the average tax rate falls as the tax base rises.

Regulatory capture Occurs when government regulates an industry for the benefit of the producers.

Rent Payment for use of land or buildings.

Rent seeking Attempting to gain economic rents.

Rent-seeking costs Resources expended by firms in order to gain economic rents.

Replacement rates Income from social assistance as a percentage of income from employment.

Representative democracy A system in which voters elect representatives to make collective decisions on their behalf.

Revealed preference valuations Inferring preferences or willingness to pay values from behaviour.

Revenue sharing Occurs when various levels of government share tax revenue on a predetermined basis, with no restrictions on the use of the funds.

Risk aversion A preference for safe, low returns over prospects with higher mean returns but more variance.

Risk pooling Occurs when investments are pooled over a large number of projects and total risk is minimised.

Second-best theorem When there is more than one market failure, the correction of one market failure may not increase economic efficiency.

Selective tax A tax that is levied on only part of the tax base, or that allows exemptions and deductions from the general tax base.

Sensitivity analysis A method of assessing risk by indicating how the estimated net present value of a project changes with variations in the values of particular inputs.

Shadow prices The underlying real economic cost of an economic variable.

Short run marginal cost The cost of supplying an additional unit of output in the short run.

Social indifference curve The combination of outcomes between which society is indifferent.

Social opportunity cost of capital The full rate of return on capital, including the return to government.

Social time preference rate The discount rate that maximises inter-temporal social welfare.

Social welfare The collective welfare of society.

Social welfare function The level of social welfare expressed as a function of the utility of each member of society or of other factors that contribute to welfare.

Source taxes Income or production is taxed at source.

Specific purpose grants Grants with conditions attached to the use of the grant.

Stated preference Eliciting individuals’ willingness to pay for goods from their stated values or choices.

Statutory incidence Indicates who is legally responsible for paying a tax.

Subsidiarity principle Public services should be supplied at the level of government closest to the users of the service unless this is not cost-effective.
Substitution effect The change in consumption of a good due to a change in relative prices.

Substitute goods Two goods are substitutes if a change in the price of one good leads to a change in demand for another good.

Taxable income The amount of income that is subject to tax.

Tax avoidance The legal rearrangement of business activities so as to minimise tax liabilities.

Tax base The economic activity or item on which a tax is levied.

Tax bracket Range of income subject to a given marginal tax rate.

Tax capitalisation The process by which a stream of present and expected future taxes is incorporated into the present capital value of an asset.

Tax deduction Expense or allowance that may be deducted from income and so reduces taxable income.

Tax effort The ratio of tax collections to tax capacity.

Tax evasion Noncompliance with the tax laws.

Tax expenditure A tax concession.

Tax exporting Shifting some of the burden of taxation onto firms or households in other jurisdictions.

Tax hypothecation Links the revenue from a tax to a specified kind of expenditure.

Tax imputation Recipients of dividends receive tax credits for profit tax paid by the company.

Tax indexation Automatic adjustment of the tax schedule to compensate for inflation.

Tax rate The rate at which a tax is levied on the tax base.

Tax rate structure The relationship between the taxes collected over a given period and the tax base, typically categorised as proportional, progressive or regressive.

Tax rebate Deductions from income tax payments.

Tax schedule Tax liability associated with each level of taxable income.

Tax unit The unit on which the tax is levied.

Tax wedge The difference between what consumers pay for a good and what producers receive for it (after tax).

Theorem of comparative advantage Two parties gain from trade whenever the parties have a comparative advantage in the production of some good.

Time series data Data for a variable or set of variables at different times.

Transaction costs The costs associated with negotiating, monitoring and enforcing contracts.

Transfer payment A payment that is independent of the performance of any service.

Transfers in-kind Governments payments to individuals in the form of goods or services rather than as cash payments.

Transfer pricing The price that one part of an organisation charges to another part.

Transitional equity Fairness in changing policies or taxes.

Transitivity Consistent ranking of alternatives.

Turnover taxes Taxes levied at a fixed rate on the gross value of sales.

Two-part tariff A pricing system where users are charged both for access to a system and for its use.

Unit tax A given amount of tax per unit of commodity purchased.

Unitary state A state where the central government has supreme authority to make laws for the whole country.

User charges Prices paid for goods or services.

Utility A term for a persons’ welfare or satisfaction..

Utility function An equation that relates an individual’s utility to the amounts of goods that he or she consumes (or to their income and leisure).

Utility possibilities frontier Shows the maximum utility that one person can achieve given the utility of the other person.

Value-added tax A percentage tax on value added at each stage of production.

Variable costs Costs that change in response to changes in the level of output.

Vertical equity Individuals with greater economic capacity should pay more tax than individuals with lower capacity.

Vertical fiscal imbalance The imbalance between the expenditure responsibilities and taxing powers of different levels of government.

Wage tax credit Payment to a firm to subsidise wage payments usually for low wage rate workers.

Welfare economics Economic theory concerned with the social desirability of alternative economic states.

Willingness to accept The minimum amount that an individual is willing to accept as compensation for the loss of a good and be no worse off than before.

Willingness to pay The maximum amount an individual is willing to pay for a good and be as well off as he is without it.