Glossary

Absolute advantage. An advantage that a country has in producing certain goods or *services* relative to all or many other countries due to specific factors of production at its disposal—such as rich farmland and a favorable climate for agricultural production or a highly educated labor force for high-tech manufacturing. A country's absolute advantage means that it can produce certain goods or services at a lower cost than would be possible for other countries. Thus it is clearly beneficial for this country to specialize in producing and exporting these goods and services. But even countries that do not have any absolute advantages can benefit from international trade; see *comparative advantage.*

Access to safe water. The percentage of the population with reasonable means of getting safe water—either treated surface water or clean untreated water from springs, wells, or protected boreholes.

Accumulation of capital. Using *investment* to build *capital* assets.

Adult illiteracy. The percentage of the population 15 and older who cannot, with understanding, read and write a simple statement about their everyday life.

Age dependency ratio. The ratio of the nonworking population—people under 15 or over 65—to the working population—people 15–64. In 1996 the average ratio for *low-income countries* was 0.7, for middle-income countries 0.6, and for *high-income countries* 0.5.

Agriculture. The sector of an economy that includes crop production, animal husbandry, hunting, fishing, and forestry.

Birth rate. The number of live births in a year expressed as a percentage of the population or per 1,000 people.

Capital (capital assets). A stock of wealth used to produce goods and services. Modern economists divide capital into *physical capital* (also called *produced assets*), *natural capital,* and *human capital.*

Carbon dioxide emissions per capita. The amount of carbon dioxide a country releases into the atmosphere during a certain period—usually one year—divided by the total population of that country. Large amounts of carbon dioxide are released when people burn *fossil fuels* and biomass—fuelwood, charcoal, dung—to produce energy.

Chlorofluorocarbons (CFCs). Cheap synthetic gases that serve as coolants in refrigerators and air conditioners and as propellants in aerosol spray cans. Although originally considered harmless, CFCs are now known to accumulate in the earth's atmosphere, where they destroy the protective *ozone* layer and trap the sun's heat—contributing to the greenhouse effect (see *greenhouse gases*). The use of CFCs is now controlled by the Montreal Protocol, an agreement signed by many countries.

Comparative advantage. The concept, formulated by British economist David Ricardo, according to which economic agents—people, firms, countries—are most efficient when they do the things that they are best at doing. Comparative advantage is particularly important in global markets, where countries benefit most by producing and exporting goods and *services* that they can produce more efficiently (at a lower cost, by using less *physical, human,* and *natural capital*) than other goods and services. In particular, Ricardo showed that a country can benefit from international trade even if it has higher costs of production for all traded goods and services relative to the countries it trades with—that is, even if it has no *absolute advantages* whatsoever. This can be done by correctly choosing the country's international specialization in accordance with its comparative advantages. In this case, by using export earnings to import other goods and service at prices that are lower than the costs of their domestic production, the country will maximize the overall volume of national production and consumption.

Countries with transition economies (transition countries, transition economies). Countries moving from centrally planned to market-oriented economies. These countries—which include China, Mongolia, Vietnam, former republics of the Soviet Union, and the countries of Central and Eastern Europe—contain about one-third of the world's population.

Death rate. The number of deaths in a year expressed as a percentage of the population or per 1,000 people.

Demilitarization. Orientation of a country's economy away from military production. The opposite of *militarization.*

Demography. The scientific study of human populations, including their size, composition, distribution, density, and growth as well as the causes and socioeconomic consequences of changes in these factors.

Developed countries (industrial countries, industrially advanced countries). *High-income countries,* in which most people have a high *standard of living.* Sometimes also defined as countries with a large stock of *physical capital,* in which most people undertake highly specialized activities. According to the *World Bank* classification, these include all high-income economies except Hong Kong (China), Israel, Kuwait, Singapore, and the United Arab Emirates. Depending on who defines them, developed countries may also include middle-income *countries with transition economies,* because these countries are highly industrialized. Developed countries contain about 15 percent of the world's population. They are also sometimes referred to as "the North."

Developing countries. According to the *World Bank* classification, countries with low or middle levels of *GNP per capita* as well as five *high-income developing economies*—Hong Kong (China), Israel, Kuwait, Singapore, and the United Arab Emirates. These five economies are classified as developing despite their high per capita income because of their economic structure or the official opinion of their governments. Several *countries with transition economies* are sometimes grouped with developing countries based on their low or middle levels of per capita income, and sometimes with *developed countries* based on their high industrialization. More than 80 percent of the world's population lives in the more than 100 developing countries.

Economic development. Qualitative change and restructuring in a country's economy in connection with technological and social progress. The main indicator of economic development is increasing *GNP per capita* (or *GDP* per capita), reflecting an increase in the economic productivity and average material well-being of a country's population. Economic development is closely linked with *economic growth.*

Economic growth. Quantitative change or expansion in a country's economy. Economic growth is conventionally measured as the percentage increase in *gross domestic product (GDP)* or *gross national product (GNP)* during one year. Economic growth comes in two forms: an economy can either grow "extensively" by using more resources (such as *physical, human,* or *natural capital*) or "intensively" by using the same amount of resources more efficiently (productively). When economic growth is achieved by using more labor, it does not result in per capita income growth (see Chapter 4). But when economic growth is achieved through more productive use of all resources, including labor, it results in higher per capita income and improvement in people's average *standard of living.* Intensive economic growth requires *economic development.*

Energy use per capita. The amount of energy a country consumes in a certain period—usually one year—divided by the population of that country. This includes fossil fuels burned by machines (such as cars), as well as electricity generated from nuclear power, geothermal power, hydropower, and fossil fuels. No matter what its source, energy use per capita is measured in equivalent amounts of oil. Though substantial in some *developing countries,* energy from biomass—fuelwood, charcoal, dung—is not considered in this statistic because reliable data are not available.

European Union (EU). A regional international organization with most *developed countries* of Europe among its members. In 1995 it succeeded the European Economic Community (EEC), established in 1957 to promote economic integration among its member countries.

Externalities. Effects of a person's or firm's activities on others which are not compensated. Externalities can either hurt or benefit others—they can be negative or positive. One negative externality arises when a company pollutes the local environment to produce its goods and does not compensate the negatively affected local residents. Positive externalities can be produced through primary education—which benefits not only primary students but also society at large. Governments can reduce negative externalities by regulating and taxing goods with negative externalities. Governments can increase positive externalities by subsidizing goods with positive externalities or by directly providing those goods.

Fertility rate. See *total fertility rate.*

Foreign direct investment. *Foreign investment* that establishes a lasting interest in or effective management control over an enterprise. Foreign direct investment can include buying shares of an enterprise in another country, reinvesting earnings of a foreign-owned enterprise in the country where it is located, and parent firms extending loans to their foreign affiliates. *International Monetary Fund (IMF)* guidelines consider an investment to be a foreign direct investment if it accounts for at least 10 percent of the foreign firm's voting stock of shares. However, many countries set a higher threshold because 10 percent is often not enough to establish effective management control of a company or demonstrate an investor's lasting interest.

Foreign investment. *Investment* in an enterprise that operates outside the investor's country. See also *foreign direct investment* and *portfolio investment.*

Fossil fuels. Coal, natural gas, and petroleum products (such as oil) formed from the decayed bodies of animals and plants that died millions of years ago. A *nonrenewable* source of energy.

General Agreement on Tariffs and Trade (GATT). From 1947 until 1995, an international organization with a mandate to reduce *protection* and promote free trade among nations. Many barriers to trade—*import tariffs, import quotas,* and others—were reduced during its eight rounds of international negotiations. Issues discussed during the last round of GATT negotiations, in Uruguay (1986–94), included reducing government restrictions on *foreign investment* and on trade in services such as banking, insurance, transport, tourism, and telecommunications. In 1995 GATT was succeeded by the *World Trade Organization (WTO).*

GNP per capita. A country's *gross national product (GNP)* divided by its population. Shows the income each person would have if GNP were divided equally. Also called *income per capita.* GNP per capita is a useful measure of economic productivity, but by itself it does not measure people's well-being or a country's success in development. It does not show how equally or unequally a country's income is distributed among its citizens. It does not reflect damage made by production processes to natural resources and the environment. It does not take into account any unpaid work done within households or communities or production taking place in the *gray* (shadow) *economy.* It attributes value to anything being produced whether it harms or contributes to general welfare (for example, medicines and chemical weapons). And it ignores the value of such elements of people's well-being as leisure or freedom.

Gray economy (shadow economy). Consists of business activities that are not accounted for by official statistics. It includes illegal activities (or the so-called black market) and activities that are in themselves legal but go unreported or under-reported for purposes of tax evasion.

Greenhouse gases. Gases that trap the sun's heat within the earth's atmosphere, creating a greenhouse effect that may dangerously raise temperatures around the globe. Greenhouse gases include *ozone,* methane, water vapor, nitrous-oxide, carbon dioxide, and *chlorofluorocarbons (CFCs).*

Gross domestic investment rate. All the outlays made to replace and increase a country's *physical capital,* plus changes in inventories of goods, expressed as a percentage of GDP. Gross domestic investment, along with *foreign direct investment,* is critical for *economic growth* and *economic development.*

Gross domestic product (GDP). The value of all final goods and *services* produced in a country in one year (see also *gross national product*). GDP can be measured by adding up all of an economy's incomes—wages, interest, profits, and rents—or expenditures—consumption, *investment*, government purchases, and net exports (exports minus imports). Both results should be the same because one person's expenditure is always another person's income, so the sum of all incomes must equal the sum of all expenditures.

Gross domestic saving rate. *Gross domestic product (GDP)* minus consumption by government and the private sector, expressed as a percentage of GDP. A high gross domestic saving rate usually indicates a country's high potential to invest. See also *savings.*

Gross enrollment ratio. The number of students enrolled at a certain level of education as a percentage of the population of the age group that officially corresponds to that level. Can be above 100 percent if some enrolled students are older or younger than the age group that officially corresponds to that level of education.

Gross national product (GNP). The value of all final goods and *services* produced in a country in one year (*gross domestic product*) plus income that residents have received from abroad, minus income claimed by nonresidents. GNP may be much less than GDP if much of the income from a country's production flows to foreign persons or firms. But if the people or firms of a country hold large amounts of the stocks and bonds of firms or governments of other countries, and receive income from them, GNP may be greater than GDP. For most countries, however, these statistical indicators differ insignificantly (see Chapter 2).

"Gross" indicates that the value lost through the "wear and tear" of capital used in production is not deducted from the value of total output. If it were deducted, we would have a measure called **net domestic product (NDP),** also known as **national income.** The words "product" and "income" are often used interchangeably, so *GNP per capita* is also called *income per capita.*

Gross primary school enrollment ratio. The ratio of primary school enrollment to the number of primary school-aged children (usually children 6–11). The **gross secondary school enrollment ratio** is calculated in the same way, except that the corresponding age group is 12–17. For the **gross tertiary education enrollment ratio,** calculations are based on the number of young people in the five-year age group following the secondary school leaving age. Gross enrollment ratios can be higher than 100 percent because some students are younger or older than the corresponding age group.

High-income countries. Classified by the *World Bank* in 1997 as countries whose *GNP per capita* was $9,386 or more in 1995. The group includes both *developed countries* and *high-income developing economies.*

High-income developing economies. Economies that the United Nations classifies as developing even though their per capita incomes would place them with *developed countries.* This classification may be based on their economic structure or the official opinion of their governments. In 1995 this group included Hong Kong (China), Israel, Kuwait, Singapore, and the United Arab Emirates.

Human capital. The knowledge, skills, and experience of people that make them economically productive. Human capital can be increased by investing in education, health care, and job training.

Human development index (HDI). A composite of several social indicators that is useful for broad cross-country comparisons even though it yields little specific information about each country. First used in the United Nations Development Programme's *Human Development Report 1990.*

Human resources. The total quantity and quality of human effort available to produce goods and services. The muscle power and brain power of human beings. Human resources can be viewed as consisting of raw labor—determined mostly by the number of people in a country's *labor force*—combined with *human capital.*

Import quotas. Government-imposed limits on the quantities of certain goods and services allowed to be imported. Like *import tariffs,* import quotas are used by governments to protect domestic industries from foreign competition. See *protection.*

Import tariffs. Taxes imposed on certain imported goods or *services.* May be levied as a percentage of the value of imports or as a fixed amount per unit. Used to increase government revenue and protect domestic industries from foreign competition. See *protection.*

Income per capita. Another term for *GNP per capita.*

Industrial countries. See *developed countries.*

Industrialization. The phase of a country's *economic development* in which *industry* grows faster than *agriculture* and gradually comes to play the leading role in the economy.

Industry. The sector of an economy that includes mining, construction, manufacturing, electricity, gas, and water.

Infant mortality rate. Of every 1,000 infants born, the number that die before reaching their first birthday.

International Monetary Fund (IMF). An international institution founded in 1944—together with the *World Bank*—to promote international monetary cooperation and facilitate balanced growth of trade by encouraging the removal of foreign exchange restrictions, promoting exchange rate stability, and expediting payments among member countries.

International poverty line. An income level established by the *World Bank* to determine which people in the world are poor—set at $1 a day per person in 1985 international *purchasing power parity (PPP)* prices. A person is considered poor if he or she lives in a household whose daily income or consumption is less than $1 per person. Although this *poverty line* is useful for international comparisons, it is impossible to create an indicator of poverty that is strictly comparable across countries. The level of $1 a day per person is close to national poverty lines in *low-income countries* but considerably lower than those in *high-income countries.*

Investment. Outlays made by individuals, firms, or governments to add to their *capital.* From the viewpoint of individual economic agents, buying property rights for existing capital is also an investment. But from the viewpoint of an economy as a whole, only creating new capital is counted as an investment. Investment is a necessary condition for *economic growth.* See *savings, gross domestic saving rate,* and *gross domestic investment rate.*

Labor force. All the economically active people in a country between 15 and 65. Includes all employed persons, the unemployed, and members of the armed services, but excludes students and unpaid caregivers such as homemakers.

Least developed countries. *Low-income countries* where, according to the United Nations, *economic growth* faces long-term impediments—such as structural weaknesses and low *human resources* development. A category used to guide donors and countries in allocating foreign assistance.

Life expectancy at birth. The number of years a newborn baby would live if, at each age it passes through, the chances of his/her survival were the same as they were for that age group in the year of his/her birth. The change in this indicator reflects changes in the overall health of a country's population, in people's living conditions, and in the quality of health care.

Living standard. See *standard of living.*

Low-income countries. Classified by the *World Bank* in 1997 as countries whose *GNP per capita* was $765 or less in 1995.

Manufactured goods. Goods produced using *primary goods.* Include petroleum, steel, textiles, and baked goods.

Market failures. Cases when a market economy fails to provide people with a desirable supply of certain kinds of goods and *services.* Market failures can occur in a market economy when it does not produce enough *public goods* and goods with positive *externalities,* when it produces too many goods with negative externalities, when goods are overpriced by *natural monopolies,* and when market agents do not have access to sufficient information, such as information about the quality of some consumer goods. These market failures usually justify economic intervention by the government. But there is always the risk of government failure—in which faulty political processes or institutional structures prevent government measures from improving social welfare (see Chapter 11).

Market liberalization. Removing and abstaining from using state controls that impede the normal functioning of a market economy—for example, lifting price and wage controls and *import quotas* or lowering taxes and *import tariffs.* Market liberalization usually does not mean that a government completely abstains from interfering with market processes.

Middle-income countries. Classified by the *World Bank* in 1997 as countries whose *GNP per capita* was between $766 and $9,385 in 1995. These countries are further divided into lower-middle-income countries ($766–$3,035) and upper-middle-income countries ($3,036–$9,385).

Militarization. Orientation of a country's economy toward military production. The opposite of *demilitarization.*

Natural capital. A stock of *natural resources*—such as land, water, and minerals—used for production. Can be either *renewable* or *nonrenewable.*

Natural monopoly. A situation that occurs when one firm in an industry can serve the entire market at a lower cost than would be possible if the industry were composed of many smaller firms. Gas and water utilities are two classic examples of natural monopolies. These monopolies must not be left to operate freely; if they are, they can increase prices and profits by restricting their output. Governments prevent such a scenario by regulating utility monopolies or providing utility services themselves.

Natural population increase. The difference between the *birth rate* and the *death rate* over a period of time. See also *population growth rate.*

Natural resources. All "gifts of nature"—air, land, water, forests, wildlife, topsoil, minerals—used by people for production or for direct consumption. Can be either *renewable* or *nonrenewable.* Natural resources include *natural capital* plus those gifts of nature that cannot be stocked (such as sunlight) or cannot be used in production (such as picturesque landscapes).

Net official assistance. The sum of grants and concessional loans from donor country governments to recipient countries, minus any repayment of loan principal during the period of the loans.

Net private flows. Privately financed capital flows that enter a country on market terms, minus such flows that leave the country. An example of a net private flow is net portfolio investment—the value of stocks and bonds bought by foreign investors minus the value of stocks and bonds sold by them. See also *portfolio investment.*

Nominal indicator. An indicator measured using the prices prevailing at the time of measurement. A change in a nominal indicator sometimes reflects changing market prices more than any other changes (changes in the *real indicator*). For example, during periods of inflation, nominal wages can increase while their real value decreases.

In making cross-country comparisons, this term also applies to the conversion of indicators calculated in local currency units into some common currency, most often US dollars. Nominal indicators are those converted into US dollars using current exchange rates, while real indicators are calculated based on *purchasing power parity (PPP) conversion factors.*

Nonrenewable natural resources. *Natural resources* that cannot be replaced or replenished. See *renewable natural resources.*

Organisation for Economic Co-operation and Development (OECD). An organization that coordinates policy among *developed countries.* OECD member countries exchange economic data and create unified policies to maximize their countries' *economic growth* and help nonmember countries develop more rapidly. The OECD arose from the Organisation for European Economic Co-operation (OEEC), which was created in 1948 to administer the Marshall Plan in Europe. In 1960, when the Marshall Plan was completed, Canada, Spain, and the United States joined OEEC members to form the OECD.

Ozone. A gas that pollutes the air at low altitudes, but that high in the atmosphere forms a thin shield protecting life on earth from harmful solar radiation. *Chlorofluorocarbons (CFCs)* destroy this high-level ozone layer.

Physical capital (produced assets). Buildings, machines, and technical equipment used in production plus inventories of raw materials, half-finished goods, and finished goods.

Population growth rate. The increase in a country's population during a certain period—usually one year—expressed as a percentage of the population when the period began. The population growth rate is the sum of the difference between the *birth rate* and the *death rate*—the *natural population* *increase*—and the difference between the population entering and leaving the country—the net migration rate.

Portfolio investment. Stock and bond purchases that, unlike direct investment, do not create a lasting interest in or effective management control over an enterprise. See *foreign direct investment.*

Postindustrialization. The phase in a country's *economic development* that follows *industrialization* and is characterized by the leading role of *service sector* in the national economy.

Poverty line. The income level people require to buy life's basic necessities—food, clothing, housing—and satisfy their most important sociocultural needs. The poverty line changes over time and varies by region. Also called *subsistence minimum.*

Primary goods. Goods that are sold (for consumption or production) just as they were found in nature. Include oil, coal, iron, and agricultural products like wheat or cotton. Also called commodities.

Produced assets. See *physical capital.*

Production resources. The main inputs for any production. Traditionally, economists identified three factors of production: labor, land, and capital. More recently, economists came to use the concept of three types of capital: *physical* (or *produced*) *capital, human capital,* and *natural capital.*

Productivity (economic productivity, efficiency). Output of goods and *services* per unit of input—for example, per unit of labor (labor productivity), per unit of energy (such as *GNP* per unit of energy use), or per unit of all *production resources* combined (see Chapter 2).

Protection. The imposition of *import tariffs, import quotas,* or other barriers that restrict the flow of imports. The opposite of "free trade." Used to:

- Protect "strategically important" industries—such as *agriculture*—without which a country would be vulnerable in times of war.
- Protect new industries until they are strong enough to compete in international markets.
- Retaliate against protectionist policies of trade partners.

Since World War II protectionist policies have been significantly reduced in most countries through negotiations under the *General Agreement on Tariffs and Trade (GATT).*

Public goods. Goods that are nonrival—consumption by one person does not reduce the supply available for others—and nonexcludable—people cannot be prevented from consuming them. These characteristics make it impossible to charge consumers for public goods, so the private sector is not interested in supplying them. Instead, they are often supplied by government. Public goods are usually national or local. Defense is a national public good—benefiting the entire population of a country. Rural roads are local public goods, benefiting a smaller group of people. There can also be global public goods, benefiting most of the world's population, for example global peace and security, or information needed to prevent global climate change. Providing such goods (and *services*) is a function of international organizations.

Purchasing power parity (PPP) conversion factor. The PPP conversion factor shows how much of a country's currency is needed in that country to buy what $1 would buy in the United States. By using the PPP conversion factor instead of the currency exchange rate, we can convert a country's *GNP per capita* calculated in national currency units into GNP per capita in U.S. dollars while taking into account the difference in domestic prices for the same goods. Thus PPP helps us compare GNPs of different countries more accurately. Because prices are usually lower in *developing countries,* their GNP per capita expressed in PPP dollars is higher than their GNP per capita expressed in U.S. dollars. In *developed countries* the opposite is true (see Chapter 2).

Quality of life. People's overall well-being. Quality of life is difficult to measure (whether for an individual, group, or nation) because in addition to material well-being (see *standard of living*) it includes such intangible components as the quality of the environment, national security, personal safety, and political and economic freedoms.

Real indicator. An economic indicator that uses the prices from some base year. This approach controls for fluctuating market prices so that other economic changes can be seen more clearly. In cross-country comparisons, this term also applies to the conversion of indicators calculated in local currency units into some common currency, most often US dollars. Real indicators are calculated with the help of *purchasing power parity (PPP) conversion factors,* while *nominal indicators* are those converted into US dollars using current exchange rates.

Renewable natural resources. *Natural resources* that can be replaced or replenished by natural processes or human action. Fish and forests are renewable natural resources. Minerals and *fossil fuels* are *nonrenewable natural resources* because they are regenerated on a geological, rather than human, time scale. Some aspects of the environment—soil quality, assimilative capacity, ecological support systems—are called semirenewable because they are regenerated very slowly on a human time scale.

Savings. Income not used for current consumption. See also *gross domestic sav-*

ing rate and *gross domestic investment rate.*

Services. Intangible goods that are often produced and consumed at the same time. An example is education: students consume a lesson—an educational service—at the same time a teacher produces it. The service sector of the economy includes hotels, restaurants, and wholesale and retail trade; transport, storage, and communications; financing, insurance, real estate, and business services; community and social services (such as education and health care); and personal services.

Shadow economy. See *gray economy.*

Standard of living. The level of well-being (of an individual, group or the population of a country) as measured by the level of income (for example, *GNP per capita*) or by the quantity of various goods and *services* consumed (for example, the number of cars per 1,000 people or the number of television sets per capita). See also *quality of life.*

Subsistence minimum. Another term for *poverty line.*

Sustainable development. According to the United Nations World Commission on Environment and Development (1987), sustainable development is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." According to the more operational (practice-oriented) definition used by the *World Bank,* sustainable development is "a process of managing a portfolio of assets to preserve and enhance the opportunities people face." Sustainable development includes economic, environmental, and social sustainability, which can be achieved by rationally managing *physical, natural,* and *human capital.*

Terms of trade. The ratio of export prices to import prices. A high ratio benefits an economy, because then the country can pay for many imports by selling a small amount of exports. If terms of trade worsen, the country needs to sell more exports to buy the same amount of imports.

Total fertility rate. The average number of children a woman will have during her lifetime, by country or region. Between 1980 and 1995 the average fertility rate in *low-income countries* and *middle-income countries* fell from 4.1 to 3.1, while in *high-income countries* it fell from 1.9 to 1.7.

Transfer payments. Payments from the government to individuals used to redistribute a country's wealth. Examples are pensions, welfare, and unemployment benefits.

Transition countries. See c*ountries with transition economies.*

World Bank. An international lending institution that aims to reduce poverty and improve people's lives by strengthening economies and promoting *sustainable development.* Owned by the governments of its 181 member countries, the Bank lends about $20 billion a year to development projects, provides technical assistance and policy advice, and acts as a catalyst for *investment* and lending from other sources. The World Bank's poorest members receive loans for up to 50 years without interest. Other needy members receive loans for 15–20 years at lower interest rates than are charged by commercial banks.

World Trade Organization (WTO). An international organization established on January 1, 1995, to succeed the *General Agreement on Tariffs and Trade (GATT).* Serves as a forum for multilateral trade negotiations and helps resolve its members' trade disputes.