
Glossary

Absolute advantage. The possibility that, due to differences in supply conditions, one country can produce a product at a lower price than another country.

Adjustable gold peg. An international financial arrangement that was part of the Bretton Woods system. It involved pegging the US dollar to gold at US\$35 per ounce and allowing all other countries to either peg to the US dollar or directly to gold. The currency pegs (other than the US dollar) were to remain fixed except under conditions that were termed “fundamental disequilibrium.”

Appreciation. An increase in the value of a currency under a flexible or floating exchange rate regime.

Assets. Financial objects characterized by a monetary value that can change over time and making up individuals’ and firms’ wealth portfolios.

Assets approach. A model of exchange rate determination that views foreign exchange deposits as assets held as part of an overall wealth portfolio.

Autarky. A situation of national self sufficiency in which a country does not import or export.

Backward linkages. The purchase of goods from local suppliers by foreign multinational enterprises.

Balance of payments. A detailed set of economic accounts focusing on the transactions between a country and the rest of the world. Two important sub-accounts are the current account and the capital account.

Binding. A major GATT/WTO principle. As negotiations proceed through the rounds of trade talks, tariffs are bound at the agreed-upon level. They may not in general be increased in the future.

Brady Plan. A set of procedures proposed by US Treasury Secretary Nicholas Brady and approved by the IMF in 1989. The Brady Plan allowed IMF and World Bank lending to be used by developing countries to buy back discounted international debt. It was a partial but important response to the developing country debt crisis that began in the 1980s.

Bretton Woods system. An international financial system introduced at the Bretton Woods conference in 1944 involving an exchange rate arrangement known as the adjustable gold peg.

Capital account. A subsection of the balance of payments recording transactions between a country and the world economy that involve the exchange of assets.

Capital deepening. An increase in the overall capital-labor ratio in a country.

Capital flight. A situation in which investors sell a country's assets and reallocate their portfolios towards other countries' assets. It tends to cause a capital account deficit for the country in question.

Capital gain (loss). An increase (decrease) in the price of an asset.

Change in demand. A shift of a demand curve due to a change in income, wealth, preferences, expectations, and prices of related goods.

Change in quantity demanded. A movement along a demand curve due to a change in the price of a good.

Change in quantity supplied. A movement along a supply curve due to a change in the price of the good.

Change in supply. A shift of the supply curve due to a change in technology or input prices.

Circular flow diagram. A graphical representation of the flow of incomes and expenditures in an economy. It involves firm, household, government, capital and rest of the world accounts.

Closed economy. Similar to autarky. An economy that does not have any interactions with the world economy.

Comparative advantage. A situation where a country's relative autarkic price ratio of one good in terms of another is lower than that of other countries in the world economy.

Competitive advantage. A situation where a firm can sustain global, market competitiveness in a particular product niche.

Conditionality. Policies pursued by the World Bank and International Monetary Fund in which loans are made only to countries that promise to institute a set of prescribed policy changes.

Constant returns to scale. A condition of production in which a doubling of all inputs leads to a doubling of output.

Consumer surplus. The benefit accruing to consumers from the fact that, in equilibrium, the consumers receive a price lower than their willingness to pay for lesser quantities.

Contracting. A mode of foreign market entry where a home country firm contracts a foreign country firm to engage in production in the foreign country. Includes both licensing and franchising.

Crawling band regime. An exchange rate regime in which monetary authorities intervene to maintain the nominal exchange rate in a band of prescribed width around a central rate.

Crawling peg regime. An exchange rate regime in which a country fixes its nominal exchange rate in terms of another currency but changes this fixed rate gradually over time in small increments.

Cultural synergy. The possibility of workers within a multinational enterprise developing means to turn cultural differences into assets by identifying complementarities among cultures.

Currency board. A type of fixed exchange rate regime where the monetary authority is required to fully back up the domestic currency with reserves of the foreign currency to which the domestic currency is pegged.

Current account. A subsection of the balance of payments recording non-official transactions between a country and the world economy that do not involve the exchange of assets.

Customs union. An agreement on the part of a set of countries to eliminate trade restrictions among themselves and adopt a common external tariff.

Deflation. A fall in the overall or aggregate price level in an economy.

Demand reduction. The decrease in domestic demand made in an attempt to move an economy toward external balance.

Depreciation. A decrease in the value of a currency under a flexible or floating exchange rate regime.

Devaluation. A decrease in the value of a currency under a fixed exchange rate regime.

Direct investment. An entry in the balance of payments that records the net inflows of foreign direct investment.

Dissemination risk. The possibility of a foreign-country partner firm obtaining technology or other know-how from a home-country firm and exploiting it for its own commercial advantage.

Economic growth. A sustained increase in per capita income over time.

Efficiency seeking. One motivation for foreign direct investment which involves the pursuit of firm-level economies in which intangible assets are spread over a greater number of international productive activities.

European Community or European Union. A common market among European countries. The EC was established in 1958, the EU in 1992.

Exchange rate target zone. An exchange rate arrangement proposed by John Williamson designed to obtain the benefits of both fixed and floating exchange rate agreements. The exchange rate target zone consists of a band around the fundamental equilibrium exchange rate *or* FEER on the order of ± 10 percent.

Export promotion. An economic development strategy promoted by the World Bank in which development occurs by encouraging export sectors.

Export processing zone. An area of a host country in which multinational enterprises can locate and in which they enjoy, in return for exporting the whole of their output, favorable treatment in the areas of infrastructure, taxation, tariffs on imported intermediate goods, and labor costs.

Export subsidy. A subsidy to exports provided by the government of a country.

External balance. A situation in an economy in which trade (the current account) is balanced.

Financial intermediary. Financial institutions such as banks, mutual funds, and brokers that receive funds from savers and use these funds to make loans or buy assets, thereby placing the funds in the hands of investors.

Firm-level economies. Economies accruing to a firm from spreading the cost of intangible assets over larger numbers of production facilities, including production facilities in more than one country.

Firm-specific assets. Capabilities and resources possessed by a firm that contribute to its sustained competitiveness. They can be tangible or intangible.

Fixed exchange rate regime. An exchange rate policy in which a country sets its nominal or currency exchange rate fixed in terms of another currency.

Flexible or floating exchange rate regime. An exchange rate policy in which a country allows the value of its currency to be determined by world currency markets.

Flexible manufacturing. A recent phase of manufacturing history in which information technology combines with machinery in a way to promote rapid switching among products and processes. Also known as “Toyotism.”

Fordism. See **managerial capitalism.**

Foreign direct investment or FDI. Occurs when a firm acquires shares in a foreign-based enterprise that exceeds a threshold of between 10 to 20 percent, implying managerial control over the foreign enterprise. Contrasts with portfolio investment. FDI may be horizontal, backward vertical, or forward vertical.

Foreign market entry. Sales on the part of a firm in a foreign country via trade, contractual, or foreign direct investment modes.

Foreign savings. An inflow of funds into an economy from the rest of the world. It occurs when foreign investors buy the assets of the economy in question.

Forward rate. The rates of current contracts for transactions in currencies that usually take place one, three, or six months in the future.

Free trade area. An agreement on the part of a set of countries to *eliminate* trade restrictions among themselves. In contrast to a customs union, it does not involve a common external tariff.

Fundamental accounting equatons. Derived from the circular flow diagram, it appears in two forms the first is Domestic Investment – Domestic Savings = Foreign Savings = Trade Deficit. The second is Domestic Savings – Domestic Investment = Foreign Investment = Trade Balance.

Fundamental equilibrium exchange rate or FEER. An exchange rate concept developed by John Williamson. The FEER can be thought of as the purchasing power exchange rate, although this is not its exact definition. In Williamson’s proposal, the FEER acts as the centerpoint of an exchange rate target zone.

Gains from trade. Advantages that accrue to a country from engaging in importing and exporting relationships. In an absolute advantage framework, gains from trade are identified as a net gain between consumer and producer surplus effects. In a comparative advantage framework, gains from trade are identified as an increase in consumption of all goods.

General Agreement on Tariffs and Trade or GATT. Established in 1946, the GATT was to be part of an International Trade Organization. The ITO was never ratified, but the GATT and its Articles served as an international vehicle for trade relationships until 1995

when it became embodied in the Marrakesh Agreement establishing the World Trade Organization. As part of the Marrakesh Agreement, it is now known as GATT 1994.

General Agreement on Trade in Services or GATS. Part of the Marrakesh Agreement of 1994. Applies the GATT/WTO principle of nondiscrimination to a restricted number of services.

Gini coefficient. A summary measure of the Lorenz curve that gives an overall value to the degree of income inequality. It varies between zero (perfect equality) and one (perfect inequality).

Gold standard. An international financial arrangement in existence from approximately 1870 to 1914. Under the gold standard, countries defined the value of their currencies in terms of gold and held gold as official reserves.

Gold-exchange standard. An international financial arrangement introduced in the 1920s to replace the gold standard. It consisted of a set of center countries tied to gold and a set of periphery countries tied to the center country currencies.

Gross domestic product or GDP. The value of all final goods and services produced within a country's borders during a year.

Gross national product or GNP. The value of all final goods and services produced by a country's factors of production during a year.

Growth. See **economic growth**.

Growth theory. In its "old" and "new" variants, growth theory is the explanation of economics of the sustained increase in per-capita incomes over the long run. It is based on the intensive production function.

Grubel-Lloyd index. An index of the degree of *intra*-industry trade that varies between 0 and 100.

Heckscher-Ohlin model. A model of international trade based on differences in factor endowments among the countries of the world.

Home base. The country in which a multinational enterprise is incorporated and holds its central administrative capabilities.

Human capital. Investments made in the education, training, and capabilities of a labor force.

Human development (index). A conception of economic development introduced by the United Nations Development Program that stresses health and education levels along with per capita income. The human development index (HDI) is reported in the annual *Human Development Report*.

Import licenses. A right to import under a quota given either to domestic importers or foreign exporters.

Import substitution. A development strategy that attempts to replace previously-imported goods with domestic production.

Industrial capitalism. An early phase in the history of manufacturing in which the focus was on the procurement of industrial inputs on the part of colonial powers from their colonies in order to promote the manufactured exports of the colonial powers.

Inflation. An increase in the overall or aggregate price level in an economy.

Intensive production function. A production function expressed on a per-capita basis.

Interest rate parity condition. The equilibrium condition in the assets approach to exchange rate determination model. It relates a country's interest rate to the expected rate of depreciation of its currency and the interest rate of another country.

Inter-industry trade. A pattern of trade in which a country *either* imports *or* exports in a given sector.

Internal balance. A situation in an economy in which all resources are fully employed.

Internalization. The process of taking a transaction along a value chain and bringing it within a firm.

International development. A concept with many meanings, including increases in per-capita incomes, improvements in health and education, structural change towards manufacturing and services production, and institutional "modernization."

International finance. The exchange of assets among the countries of the world economy.

International production. A production of a good or service with processes located in more than one country.

International trade. The exchange of merchandise and services among the countries of the world economy.

Intra-firm trade. Trade that takes place within a multinational enterprise.

Intra-industry trade. A pattern of trade in which a country *both* imports *and* exports in a given sector.

Jamaica Agreement. A 1976 amendment to the IMF's Articles of Agreement that allowed for floating exchange rates.

Local-global paradox. A term referring to the fact the global production also involves increased localization in the countries hosting foreign direct investment.

Lorenz curve. A graph relating the cumulative percentage of income to the cumulative percentage of households, the latter ranked from low- to high-income. It is a visual measure of income inequality.

Managed floating regime. An exchange rate regime in which a country allows its currency to float but intervenes in currency markets to affect its value when it determines that such intervention would be desirable.

Managerial capitalism. A middle stage in the history of manufacturing where the focus is on achieving economies of scale. Also known as "Fordism."

Market entry. The process of a home country firm supplying a foreign market through exports, contracting, or foreign direct investment.

Market seeking. A motivation for foreign direct investment in which the multinational enterprise engages in FDI to better serve a foreign market.

Marrakesh Agreement. Signed in 1994, the Marrakesh Agreement concluded the Uruguay Round of trade talks began in 1986 and established the World Trade Organization. Among others, it includes a multilateral agreement on trade in goods, an agreement on trade in services, an agreement on trade-related aspects of intellectual property rights.

Merchant capitalism. Part of the colonization efforts of the European powers during the 16th and 17th centuries which included state-supported trading companies such as the British East India Company, the Dutch East India Company, and the Royal African Company.

Monetary union. A group of member countries in a common market all using a common currency. The most notable example is the European Monetary Union or EMU.

Money demand. The amount of money households want to hold at any particular time.

Money supply. The amount of money set in an economy by a central monetary authority such as a central bank or treasury.

Most favored nation. A principle of the GATT/WTO system in which each member must treat each other member as generously as its most-favored trading partner.

Multinational enterprise. Also known as the multinational corporation or the transnational corporation. A firm operating production, sales, and service operations in more than one country.

Multinational value network. A collection of value chains in a number of countries.

National treatment. A principle of the GATT/WTO system under which foreign goods within a country should be treated no less favorable than domestic goods with regard to tax policies.

Natural rate of population growth. An exogenous measure of the rate of population growth used in growth theory.

Net factor receipts. An item in the current account of the balance of payments. It records the difference between factor income and factor payments, both of which reflect income earned on physical capital.

Nominal exchange rate. The number of units of a country's currency that trade against a world currency such as the US dollar or EU euro.

Nondiscrimination. A major GATT/WTO principle achieved via the sub-principles of most favored nation (MFN) and national treatment.

Non-tariff barrier (NTB). An import restraint other than a tariff. An quota is one example.

Non-tariff measure (NTM). An import restraint or export policy other than a tariff. An import quota is one example.

Non-traded goods. Goods such as local services that are not imported or exported.

North American Free Trade Area or NAFTA. As the name implies, a free trade area among Canada, the United States, and Mexico.

Official reserves balance. The element of the capital account of the balance of payments that reflects the actions of the world's central banks.

OLI framework. A theory of the multinational enterprise based on ownership, location, and internalization advantages.

Open-economy accounts. The accounting identities derived from the firm, household, government, capital, and rest of the world accounts of the circular flow diagram.

Opportunity cost. What has to be given up to gain something. Along a production possibilities frontier, there is an opportunity cost of increasing the output of one good in the form of less production of another good.

Optimum currency area. A collection of countries characterized by: 1. Well-integrated factor markets; 2. Well-integrated fiscal systems; and 3. Economic disturbances that affect each country in a symmetrical manner.

Overvaluation. Under a fixed exchange rate regime, a value of a home currency above its equilibrium value, which causes an excess supply of the home currency.

Ownership requirements. A limit placed on the degree of foreign ownership of firms by a country's government.

Performance requirements. A large host of measures placed on the performance of multinational enterprises by a government. A subset of these are known as trade-related investment measures.

Porter diamond. A diagrammatic and conceptual device introduced by Michael Porter to explain the sources of competitive advantage in a firm's home base.

Preferential trade area. An agreement on the part of a set of countries to *reduce but not eliminate* trade restrictions among themselves.

Price level. A measure of the average or overall level of prices in a country. Includes the GDP price deflator and the consumer price index.

Producer surplus. The benefit accruing to producers from the fact that, in equilibrium, the producers receive a price higher than their willingness to accept for lesser quantities.

Product life cycle theory. An early theory of the multinational enterprise that viewed production as being confined to the home base of an MNE during the early phases of a product life cycle due to the need for technologically sophisticated production techniques. During later phases of the production cycle, as the production of the good becomes more routine and established, production can move to subsidiaries in foreign countries in order to take advantage of lower labor costs.

Production function. A mathematical relationship between the output of a firm, sector, or economy and inputs such as labor and physical capital.

Production possibilities frontier. A diagram that illustrates the constraints on production in general equilibrium imposed by scarce resources and technology. It shows all the combinations of two goods that a country can produce given its resources and technology.

Purchasing power parity model. A long-run model of exchange rate determination based on the notion that nominal exchange rate will adjust so that the purchasing power of currencies will be the same in every country.

Quota. Usually applied to imports. A maximum amount of imports allowed by a government.

Quota premium. The increase in the domestic price of a good as a result of an import quota.

Quota rents. The income accruing to the holder of a right to import a good into a country.

Real exchange rate. The rate at which two countries *goods* (not currencies) trade against each other. The real exchange rate adjusts the nominal exchange rate using of the price levels in the two countries under consideration.

Regional trade agreement. An agreement by a number of countries to grant preferential access to their markets to other members of the agreement. Examples include free trade areas and customs unions.

Resource seeking. One of the motivations for foreign direct investment in which a multinational enterprise backward integrates into resource supply in a foreign country.

Revaluation. An increase in the value of a currency under a fixed exchange rate regime.

Rules of Origin. A means to determine whether a product is from a partner country in a regional trade agreement (RTA). These can be defined in a number of ways, including by amount of value added in an RTA partner country or by degree of product transformation, often measured by a change in tariff classification.

Smithsonian Conference. A conference that took place in Washington, DC in December 1971 to attempt to repair the damaged adjustable gold peg system of the Bretton Woods system.

Spatial cluster. A collection of interrelated firms in a geographic area that engage in cooperative information sharing and, thereby, contribute to their collective efficiency and competitiveness.

Special drawing rights or SDRs. An international currency administered by the IMF and introduced in 1969. It is currently defined in terms of a basket of three currencies: the US dollar, the euro, and the yen. Distributions of SDRs took place in 1970, 1979, and 1997, but they never played the important role envisaged for them.

Specific factors. Factors of production that cannot move easily from one sector to another.

Spot rate. The current, nominal exchange rate between two currencies.

Stolper-Samuelson theorem. A result of international trade theory concerning the politics of trade. It states that an increase in the relative price of a commodity (e.g. as a result of trade) raises the return to the factor used intensively in the production of that good and lowers the return to the other factor.

Strategic asset seeking. A motivation for foreign direct investment in which the multinational enterprise wants to acquire productive assets as part of the *strategic game* among competitors in an industry.

Structural adjustment. The process of change in an economy that takes place in response to internal and/or external imbalances. It typically requires demand reduction and currency devaluation.

Structural adjustment lending or SAL. Non-project lending of the World Bank to support adjustment in the face of balance of payments difficulties. Based on policy conditionality.

Structuralism. A school of thought in development economics that argues in favor of accounting for the historical and institutional structures of an economy in the design of adjustment programs in coping with external imbalances and balance of payments crises.

Switching. The use of a devaluation of a country's currency to move the economy towards external balance.

Tariff. A tax on imports which could be either in *ad valorem* or specific form.

Tariffication. The process of replacing quotas by equivalent tariffs.

Tariff rate quota. An import restraint involving two tariff levels: a lower tariff for levels of imports within the quota and a higher tariff for levels of imports above the quota.

Terms-of-trade effects. The effects of a country having an impact on the world prices of the merchandise and services it trades.

Tobin tax. A small tax on foreign exchange transactions proposed by James Tobin. The purpose is to reduce the volatility of flexible exchange rates by throwing "sand in the wheels of international finance."

Toyotism. See **flexible manufacturing**.

Trade creation. A potential outcome of a free trade area or a customs union in which imports switch from a high-cost source to a low-cost source.

Trade diversion. A potential outcome of a free trade area or a customs union in which imports switch from a low-cost source to a high-cost source.

Trade-related investment measures. A subset of performance requirements, including export requirement and domestic content requirements, some of which are now prohibited by the World Trade Organization.

Traded goods. Goods and services that can be imported or exported.

Transfer pricing. The manipulation of the prices of intra-firm trade by multinational enterprises to reduce their global tax payments.

Transparency. A major GATT/WTO principle prohibiting the use of quantitative restrictions on trade such as quotas. There are a number of importance exceptions to the transparency principle.

Triffin dilemma. A critique of the gold exchange standard developed by Robert Triffin. It involved a contradiction between the requirements of international liquidity and international confidence.

Undervaluation. Under a fixed exchange rate regime, a value of a home-country currency below its equilibrium value causing an excess demand for the currency.

Value chain. A series of value-added processes involved in the production of a good or service.

World Bank. An international organization founded in 1944 by the Bretton Woods Conference. It was originally designed to assist in the reconstruction of post-War Europe but quickly became a lender to developing countries in support of development projects and structural adjustment. The World Bank actually consists of the International Bank for Reconstruction and Development and the International Development Association.

World Bank Group. A collection of five organizations: the International Bank for Reconstruction and Development; the International Development Association; the International Finance Corporation; the International Center for Settlement of Investment Disputes; and the Multilateral Investment Guarantee Agency.

World Trade Organization. The WTO was established in 1995 as part of the Marrakesh Agreement ending the Uruguay Round of trade talks. It is an international organization with a legal foundation for managing world trading relationships.