
Glossary

Absolute poverty A measure of poverty based on a minimum level of consumption. The income equivalent of this consumption establishes a “poverty line”, and those below the line are counted as being in poverty.

Administration The process by which one individual or group makes decisions for other individuals or groups. Administration is hierarchical; those who decide (the administrators) have authority over those who receive the decision.

Allocation The use of resources for some purposes or in some ways or for some people rather than others.

Arbitrage Buying goods or assets in one market where they are cheaper and selling them in another where they are more expensive. When enough people engage in arbitrage this tends to equalize prices across the various markets.

Asymmetric information Occurs when one party to a transaction has more information than the other(s). Typically this is information about the party itself or goods it has direct experience with. In an employment negotiation, for instance, the worker has private information about her skills and habits, but the employer has private information about the employment situation, such as prospects for promotion. Both are potential examples of asymmetric information.

Bads Outcomes of production or consumption that have negative effects on others. If there is a market in bads, those who receive them have to be compensated. If they are uncompensated they take the form of negative externalities. Pollution that threatens human health is an example of a bad.

Bear market A market dominated by those who think the prices of the assets traded on it are likely to fall. Selling pressure in such a market will tend to exceed buying pressure, and prices really will fall.

Bears Traders in a market who expect the price to fall. They are eager to sell in order to avoid the financial losses they anticipate.

Beveridge Curve A curve showing the relationship between the number of unemployed workers in the economy and the number of vacant jobs. It is named for an influential British economist of the middle twentieth century.

Book value The value of the assets held by a firm added up individually minus its total liabilities.

Bull market A market dominated by traders who expect prices to rise. This means that buying pressure will exceed selling pressure, and that prices will tend to rise.

- Bulls** Traders who expect prices to rise. They want to buy these assets now in order to benefit from the anticipated price rise.
- Calibration** Using real-world data to make quantitative predictions from theoretical models. Technically, calibration estimates the parameters of predictive models from existing data in order to specify the relationship between the variables in these models.
- Capabilities** In Amartya Sen's theory of well-being, the human potentialities which need to be fulfilled in order for people to live desirable lives.
- Capital** Something that is the product of investment and that generates a flow of services over time. Capital can take many forms—capital goods, financial capital, human capital, social capital, etc.
- Capital goods** Goods that contribute to production for an extended period of time following their initial acquisition.
- Caveat emptor** “Let the buyer beware”. This is a legal rule that absolves the seller of liability for negative aspects of the goods they sell that careful buyers have the capacity to discover for themselves.
- Ceteris paribus** “Other things being equal”. This is the technique of holding all the factors that determine a particular outcome constant except for one, in order to examine the relationship between the outcome and that one factor.
- Coefficient** A number that serves as a weight in a regression formula. It tells what effect a change in its associated variable is expected to have on the variable the formula is set up to calculate. Computing coefficients from existing data is the main activity of regression analysis.
- Coercion** Occurs when someone is dissuaded from making a choice they would otherwise make because of a threat by someone else, when the threatened party is unable to avoid this threat by breaking off contact with the one making it.
- Collective organization** A decision-making process in which a group of people make a decision that applies only to themselves.
- Commodities market** Markets in agricultural products, minerals or other goods whose paper claims have acquired the characteristics of financial assets.
- Common property resources** Goods that are collectively owned or managed by a community of users.
- Commons** Goods, services or assets that are not owned either by private owners or government. Often commons provide services that are self-reproducing if human beings can be dissuaded from interfering with them.
- Comparable worth** A nondiscrimination principle according to which workers should be paid equally if their jobs are of equal value to the employer.
- Compensating wage differentials** Wage differences that offset nonwage differences between jobs. Ideally, people in more difficult, dangerous or unpleasant jobs should be paid more than those in easier, safer or more pleasant ones.
- Computable general equilibrium** A model of the economy that reduces it to a small number of aggregate markets and solves for the prices and outputs at which all such markets would be in equilibrium simultaneously.

Conditional income transfers Programs that provide money to low-income households in return for meeting certain conditions, such as school attendance by children or visits to health clinics.

Consumer surplus The difference between what consumers would be willing to pay and what they actually pay, i.e. the market price. Graphically, it is the area under the demand curve but above the price.

Cooperation vs defection (in a Prisoners Dilemma) Cooperation is taking an action that benefits other players; defection is taking an action that reduces the payoff to them.

Cost shifting Policies or actions that, rather than (or perhaps in addition to) reducing costs, shift them from some parties to others.

Custom A “process” for making decisions that simply continues making the same decisions that were made in the past.

Default In economics, failure to service debts or other financial obligations. A borrower may default on a loan; a business may enter into default if it cannot generate enough revenue to meet its obligations to workers, suppliers or other creditors.

Demand curve The quantity of a good or service that potential buyers are willing to acquire as a function of the price they expect to pay for it. All other determinants of their demand are assumed to be constant, the “ceteris paribus” assumption.

Demand schedule A table that shows what quantity of a good or service will be demanded at each of many possible prices.

Demographic transition A long-lasting reduction in the rate of population growth due to a restoration of balance between mortality and fertility. When life expectancy first rises, a gap opens between fertility and mortality, resulting in a rapid rate of population growth. The demographic transition is complete when fertility falls to replacement levels, so that population stabilizes. It appears that all countries go through this process, although at different rates and different time periods.

Demography The study of human population, its components and determinants.

Depletable resources Natural resources which, when used, are no longer available for future use. Minerals like petroleum and copper are examples.

Depreciation The reduction in the value of an asset, like a capital good, over time as it is used up.

Disability adjusted life year A measurement that combines years of life lost due to premature death with reductions in the functions people can exercise per year due to injuries or disease. The latter is calculated as a fraction of the former based on the degree of disability.

Discrimination Unequal treatment of equals or equal treatment of unequals.

Disutility Negative utility, the amount of discomfort, anxiety or other harm experienced by an individual.

Dividends Payments made to shareholders that distribute a portion of a firm’s profit. Shareholders derive income either from dividends or capital gains, if they can sell their stock for more than they paid for it.

- Division of labor** Different tasks are divided among different people, rather than everyone doing everything. The main form that division of labor takes in modern society is specialization in the production of different goods and services. A society with no division of labor would be one in which individuals are self-sufficient, producing all the goods they consume to survive.
- Dynamic efficiency** The extent to which an economy, or some portion of it, innovates in products or methods. This is represented graphically by an outward shift of a production possibility curve.
- Ecology** The study of the interrelationships between organisms and between them and their physical environment.
- Economic behavior** Actions that participants in an economy take that affect how that economy works. The study of economic behavior has become a central focus of economic research.
- Economic benefits** Utility that people acquire from the consumption of goods and services produced in an economy.
- Economic costs** Opportunity costs and/or disutility resulting from actions taken to produce economic benefits.
- Economic efficiency** The ratio of economic benefit to economic cost of particular actions, institutions or policies.
- Economic institutions** Rules or organizations that structure economic activity; these include aspects of firms, markets, government and civil society.
- Economic outcomes** The results of economic activity, the production and distribution of economic benefits and costs.
- Economic sustainability** The ability to maintain the existing level of utility across future generations.
- Economic vs noneconomic benefits** Economic benefits can be given acceptable monetary equivalents, either through markets or appropriate economic analysis; noneconomic benefits are outcomes that are desirable but cannot be given a monetary value.
- Economics vs economizing** Economics studies the economic benefits and costs of particular policies, institutions or actions; economizing means reducing costs only.
- Economics vs the economy** Economics is a particular approach to studying how economies work, based on a historically evolving set of concepts, theories and methods; the economy is the realm in which economic life takes place and is only partially represented by economics.
- Economies of scale** Reductions in the cost per unit of producing something based on the production of a larger quantity of units.
- Efficiency wage** A wage employers may choose to pay above the market equilibrium in order to gain an added advantage through recruiting higher-quality employees, increasing their motivation, or avoiding the costs of turnover.
- Efficient markets** Markets that reach equilibrium quickly with a minimum of false trading, that do so with few transaction costs and that, in the process, utilize all available information.

Elastic vs inelastic supply/demand The quantity supplied or demanded is elastic if its percentage change exceeds the percentage change in price; it is inelastic if it is less.

Equilibrium A situation in which all participants are acting according to their decision rules, simultaneously. If what I want to do depends on what you are doing, and if what you want to do depends on what I am doing, an equilibrium occurs when we are both doing what we want in relation to each other at the same time. One characteristic of an equilibrium is that there is no “inner” tendency for the situation to change, since no participant can see an advantage in acting differently. Note that the intersection of a supply and demand curve might be an *example* of an equilibrium, but it also might not, depending on how the underlying market is described and analyzed. An attainable equilibrium also requires a process that brings participants to an equilibrium from whatever initial situation they find themselves in.

Equitable sustainable share The amount of something, typically a nonrenewable resource, that satisfies two equity criteria, equity across people at a point in time and equity across generations over time.

Equity In finance, the surplus of a firm’s assets over its liabilities. In ethics, equity is the satisfaction of some principle of distributive justice. Economists often use the equality of income distribution as a criterion for the extent to which a set of outcomes satisfies the criterion of equity.

Event analysis A research technique that uses changes in stock prices or other financial assets after an unanticipated event to infer the economic impact of that event.

Excess demand The surplus of the amount demanded of a particular good at a particular price over the amount supplied at that price.

Excess supply The surplus of the amount supplied of a particular good at a particular price over the amount demanded at that price.

Expected utility The sum of the various possible utility outcomes of a course of action weighted by their probability of occurring. If the action were a game, this is the amount you would be willing to play the game and accept the various possible outcomes if you had no extra like or dislike of risk as such.

Externalities Beneficial effects of actions which recipients do not pay for or costly effects for which those who bear them are not compensated. In short, externalities arise because of a missing market.

Factor markets Markets for goods and services employed in production. The labor market is an especially important factor market.

False trades Transactions between buyers and sellers that take place at out-of-equilibrium prices and that would not take place at all if the market were at an equilibrium. This means that either the buyer’s willingness to pay is less than the equilibrium price or the seller’s marginal cost is above it.

Financial capital The amount of money invested in a productive activity.

Freedom of contract A legal order in which no one is obligated to undertake any action unless they have agreed to do it via a contract, and in which all commitments made under contract are enforceable. This second stipulation

indicates that people are free to make any contracts they wish; their terms will be enforced.

Functional distribution of income Its distribution across groups with different sources of income—wages, interest, rent and profit.

Fundamental Theorems of Welfare Economics (1) A general equilibrium of a perfectly competitive system of markets is Pareto optimal. (2) Any desired Pareto optimum can be arrived at by first imposing a particular reallocation of assets and then permitting the system of perfectly competitive markets to arrive at its corresponding general equilibrium.

Fundamentals approach to financial markets An approach to price forecasting based on the expected future earnings of the asset in question.

General equilibrium Occurs when all the markets that comprise an economy are in equilibrium simultaneously.

General equilibrium theory The branch of economics that studies the characteristics of general equilibrium in models of the economy. It is concerned with topics such as, do these models have a general equilibrium? If so, only one or more? What welfare properties (e.g. Pareto optimality) do these equilibria possess? What is the nature of the adjustment process to equilibrium?

General inequality Inequality across a population as measured by a statistic like the Gini coefficient.

General Theory of the Second Best If an economy is unable to avoid a distortion (price not equal to marginal cost) in one market, it is generally the case that, to achieve second best, it must have a distortion in at least one other market as well, to compensate.

General vs firm-specific human capital General human capital is productive in a wide variety of employment contexts; firm-specific human capital is productive in just a single firm.

Gift exchange A system in which individuals provide goods and services to one another without immediate compensation.

Gini coefficient The ratio of the area between a Lorenz Curve and an equal-distribution (45°) line to the entire area under the equal-distribution line. The closer the Lorenz Curve approximates the equal distribution line, the lower the Gini coefficient. 0 represents perfectly equal distribution, while 1 represents perfectly unequal distribution—one person has everything and everyone else nothing.

Green taxes Taxes on polluting or resource-depleting activities, to generate revenue for the government while reducing environmental harm.

Hartwick Rule Royalties from the extraction of depletable resources (the difference between their selling price and cost of production) should be invested to provide offsetting returns to future generations, to compensate them for having less of these resources.

Human capital Aspects of human productive capacity, like education and health, that can be enhanced by investments and which can generate economic returns over a long period of time.

Ideology Beliefs or mental frameworks that may (if common theories of ideology are correct) have a relationship to the interests or particular life experiences of

those who hold them. Ideology is a theory of why people hold particular beliefs, not whether or not those beliefs are justified.

Implicit market A market in which aspects of goods, like their quality or durability, are traded indirectly. Studying such markets makes it possible to assign market prices to characteristics of goods that are bought and sold only as part of larger “packages”.

Incentive A personal cost or benefit to taking some course of action. Economists often assume that incentives provide the only source of motivation for individuals in the economy.

Individual vs collective rationality Individual rationality occurs when people choose separately, taking the course of action that provides the largest benefit to them personally; collective rationality occurs when people act as a group, taking the course of action that provides the most benefits to them in the aggregate.

Initial public offering The process by which a privately-held firm is sold to anyone who wishes to buy shares in it. A quantity of shares is auctioned off, with each share representing a portion of the entire equity.

Institution-centered financial systems Systems in which firms are mainly financed by banks or similar institutions rather than relying on stock or bond markets.

Intellectual property rights Legal guarantees for the owners of ideas, images, music and other mental products that allow them to control access and set prices for use.

Intergenerational equity Equality of benefits across generations; not benefitting the current generation at the expense of future generations.

“Internal” freedom Freedom from addiction, convention or routine—a free mental disposition.

Invisible Hand The hypothetical process by which individuals, seeking their own personal benefit, collectively promote the benefit of society.

Labor force participation rate the proportion of working-age individuals who are either employed or seeking paid employment.

Laissez-faire The philosophy that government should regulate business as little as possible, leaving most economic decision-making to market competition.

Law of demand The “law” that the quantity demanded will fall if the market price rises and vice versa.

Liberal The philosophy that government power should be kept to a minimum, in economics but also in other aspects of life.

Libertarianism The philosophy that the only legitimate purpose of government is to prevent greater coercion though the provision of police and an army strictly devoted to national defense.

Liquid assets Assets that can be readily converted to cash.

Lorenz Curve A curve that represents the cumulative proportion of income (or wealth) accruing to different portions of the population—how much to the bottom 10 %, the bottom 20 %, the bottom 50 %, and so on, up to 100 %.

- Marginal benefit** The additional benefit provided by an additional unit of some good or service.
- Marginal consumer** The consumer who purchases the additional unit of a good or service when the price falls a small amount or who would just be priced out of the market if the price rose by a small amount.
- Marginal cost** The additional cost of producing an additional unit of some good or service.
- Marginal product** The additional output attributable to the employment of an additional unit of some factor of production.
- Marginal return on capital** The additional profit that can be earned by investing in one additional unit of capital
- Marginal time preference** The proportion by which an additional good today is preferred relative to the same good at a future point in time, such as 1 year later, by the individual who faces this choice.
- Marginal utility** The extra utility obtained from one additional unit of a good or service. Algebraically, it is the change in total utility divided by the change in the number of units acquired.
- Marginal utility of money** The extra utility an individual gets from a small change in how much money he has. It serves as an “exchange rate” between measurement in utility and measurement in money.
- Market disequilibrium** A condition in which some participants in the market are experiencing disappointment with the results of their choices based on the choices of other participants, such as excess supply and excess demand.
- Market equilibrium** A condition in which all participants in the market, both buyers and sellers, are making choices consistent with the choices made by everyone else. Typically this means that there is neither excess supply nor excess demand.
- Market failure** A condition that causes markets to achieve less-than-optimal outcomes. This can result from public goods, externalities, monopoly and asymmetric information.
- Market microstructure** The specific ways in which market participants acquire information, locate one another, bargain and transact.
- Market Welfare Model** A framework for analyzing the relationship between market equilibrium and social well-being. It stipulates that if three conditions are met—the supply curve represents marginal social cost, the demand curve represents marginal social benefit, and there is a single, stable equilibrium where they intersect—market equilibrium will maximize net social benefit.
- Market-centered financial systems** Economic systems in which firms are financed primarily by the stock and bond markets.
- Markets** Social institutions in which buyers and sellers come together to exchange goods and services, generally for money.
- Money vs “real” economic goods and services** Money is a measure of value and can be used to purchase valuable goods and services, but it is not valuable in itself. The “real” economy consists of things that are valuable in themselves.

- Monopoly** Strictly speaking, a single seller that has captured an entire market. It is common to refer to firms with very high but not complete market share, however, as monopolies.
- Moral hazard** The effect that insurance or other forms of compensation for loss can have, where individuals fail to take all possible precautions against ill events because they are (partially) protected from them.
- Movement of vs movement along a curve** Movement of a curve occurs when the ceteris paribus conditions on which it is based change; movement along a curve occurs when one of the variables the curve represents (like price or quantity in a market demand or supply curve) changes.
- Multiple equilibria** Many possible equilibrium outcomes. A market has multiple equilibria, for instance, if there are multiple combinations of price and quantity at which supply equals demand.
- Negative vs positive freedom** Negative freedom is freedom from coercion; positive freedom is the opportunity to make desired choices. These are often summarized as “freedom from” and “freedom to” respectively.
- Net economic benefits** Economic benefits minus economic costs.
- Net worth** The value of an individual or enterprise’s assets minus liabilities.
- NGO’s** Nongovernmental organizations.
- Nonaugmentable resources** Natural resources whose stock can be maintained at current levels but not increased. Such resources can often be depleted by human action, however. Biodiversity is an example of such a resource.
- Nonexclusion principle** When it is not practical to exclude users of a good or service if they don’t pay for it. This is one characteristic of a public good.
- Nonmarket interaction** A situation in which one person’s choices have effects on other people that do not occur via markets. They can occur instead through culture and communication, social networks, physical proximity, etc.
- Nonrivalry principle** There is zero or near-zero marginal cost of supplying a good or service to an additional user. This is one characteristic of a public good.
- On-the-job training** When workers acquire productive skills as part of their employment.
- Open access resources** Natural resources that are available for anyone to use, without paying or obtaining permission from an owner.
- Opportunity cost** A cost of taking a course of action equal to the value of the best alternative option foreclosed by that choice.
- Out-of-equilibrium trading** Trades that take place at prices other than the equilibrium price, usually when the market is in the process of arriving at an equilibrium.
- Pareto optimality** A condition in which it is not possible to make one individual better off without making some other individual worse off.
- Paternalism** The view that some or all people can be made better off by having choices made for them by better-informed authorities.
- Payoff matrix** A rectangular array that shows the payoffs to each individual player in a game based on the choices they make and the choices made by the other players.

- Peak oil** The point at which the maximum amount of oil that will ever be produced is being produced; after this point the level of production will continuously decline. This is based on the assumption that oil production only goes up for a period of time, after which it only goes down.
- Positive vs normative statements** Positive statements are descriptions, explanations or predictions; normative statements are evaluative (how good is this?) or prescriptive (what should someone do in this situation?).
- Potential Pareto optimality** A condition in which it is not possible to make one individual better off without making some other individuals worse off, under the proviso that those who benefit from an action fully compensate those who are harmed by it. In effect, potential Pareto optimality sets a cost-benefit test: is the monetary value of the benefit of an action greater than the monetary value of its cost? If so, there is enough “surplus” money in the benefit to compensate those who experience a cost and still leave some money left over.
- Poverty line** A level of income below which an individual or a household is regarded as being in poverty.
- Precautionary principle** A framework for decision-making that has one or more of these elements: (a) a reasonable suspicion of harm rather than proof of harm should be a sufficient basis for avoiding certain risks, (b) the burden of proof should fall on those who want to engage in or permit risky activities rather than those who want to prohibit them, (c) those who are not in a position to agree to risks (like future generations) should be protected from them, and (d) decisions about risk should be made on the basis of not only what is currently known but also what we can reasonably anticipate knowing in the future.
- Price elasticity of demand** The percentage change in the quantity demanded divided by the percentage change in price.
- Price-earnings ratio** The ratio of the value of a firm’s outstanding stock to the level of its current profit. It is one piece of evidence that can suggest whether share prices are over- or undervalued.
- Prisoner’s Dilemma** A social situation involving potential cooperation and defection in which three conditions hold: it is individually beneficial to defect when others cooperate, it is individually harmful to cooperate when others are defecting, and the individual benefits to joint cooperation are greater than to joint defection.
- Production possibility frontier** A curve that shows the maximum quantity of one good or service that can be produced in an economy given the quantities of other goods or services also being produced. In a two-good model, for instance, this frontier shows how much of the first good can be produced given various levels of the production of the second, and vice versa.
- Public goods** Goods that have at least one of two characteristics, nonexclusion and nonrivalry.
- Purchase value vs replacement value** The purchase value of a capital asset is what was paid for it; its replacement value is how much it would cost to buy a new one today.

- Quality adjusted life year** A unit of measurement that combines years of life lost due to premature death with years of life lived unfavorably due to injury or disease. The proportion of unfavorable years regarded as “lost” is determined by how much utility individuals expect to lose under that condition.
- Rational choice** Choices that maximize the decision-maker’s expected utility.
- Relative poverty** Poverty defined according to how far below the average (median) income a given household is.
- Renewable resources** Natural resources that regenerate through natural processes, like the reproduction of an animal population or the formation of new topsoil.
- Reservation wage** The lowest wage for which a worker will agree to accept employment. This is typically less than the wage actually accepted.
- Resilience** The ability of a natural system to recover from stress.
- Reward effects** The effect on overall income inequality of differences between the rewards offered for different positions in the economy.
- Risk premium** An extra interest rate that must be paid to compensate creditors for accepting a higher level of risk.
- Satisficing** Setting a minimum level of acceptable quality or a maximum acceptable price and choosing the first good or service that meets this criterion. This is an alternative to rational choice, which requires the decision-maker to maximize expected utility. In other words, it is choice based on “good enough” rather than a more demanding search for the very best.
- Selection effects** The effect on overall income inequality of differences in the proportion of different groups that attain positions that offer higher rewards.
- Signaling (in labor markets)** Making choices about education, employment etc. in order to send a message to future employers regarding one’s (unobservable) personal qualities. For instance, someone might get a college degree not for the learning it represents, but to signal to future employers that she is the sort of person who works hard to achieve a goal.
- Skill-biased technical change** The introduction of new methods of production that benefits workers with one set of skills relative to those with another. It provides a possible explanation why some workers’ wages are rising while others’ are falling.
- Social norm** Customs, habits or values that are widely shared in a society and that individuals may be penalized in some way for violating.
- Solvent/insolvent** A firm is solvent if its assets exceed its liabilities; it is insolvent otherwise.
- Static efficiency** Attaining the most output for a given input, or utilizing the least input to attain a given output. One aspect of this is distributing outputs to those who value them most and costs on those who require the least compensation for accepting them.
- Statistical significance** The likelihood that a statistical result would not result from pure chance. If a result is significant to the 5 % level, it means that there is no more than a 5 % chance that the claim that the result does *not* occur could be mistakenly rejected due to random fluctuation.

- Strong sustainability** The principle that future generations should inherit a natural environment, including stocks of natural resources, that are not diminished relative to their current quality and abundance.
- Supply curve** The quantity of a good or service that sellers wish to supply to a market as a function of the price they expect to be paid for it. All other determinants of their supply are assumed to be constant, the “*ceteris paribus*” assumption.
- Technical approach to financial markets** Strategies for buying and selling financial assets based on patterns of price movements that can be found in historical or current data.
- Tobin’s q** The ratio of the market value of a firm (the value of its outstanding stock) to its book value.
- Tragedy of the commons** The depletion of an open-access resource that results from participants overusing it in their own individual interest.
- Transaction cost** The economic cost of using a market rather than some other method of allocation. This can include search costs, the cost of drawing up contracts, and the legal and other costs that can be anticipated if contracts are violated.
- Type I versus Type II error** Type I error is believing a hypothesis to be true when it is actually false (“false positives”), while Type II error is believing a hypothesis to be false when it is actually true (“false negatives”).
- Utilitarianism** The philosophy that holds that the best action is that which maximizes the sum of society’s net benefits. It denies that there are general rules that ought to be followed irrespective of their anticipated consequences, and it denies that the distribution of costs and benefits across individuals should be allowed to override the calculation of net benefit to society as a whole.
- Utility possibility frontier** A curve that shows the maximum level of utility one person can have given the level of utility obtained by another. It is assumed to be downward-sloping; that is, if an initial allocation is efficient in the sense that A and B both have the greatest potential utility given the utility of the other, any reallocation that increases A’s potential utility must decrease B’s.
- Value of the marginal product** The amount of revenue a firm can expect to receive from selling the marginal product of an additional unit of a factor of production, such as an extra worker.
- Willingness to pay** The maximum price at which a consumer would still wish to purchase a given good or service. It is generally greater than the amount that must actually be paid (the market price), with the difference constituting consumer surplus.

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