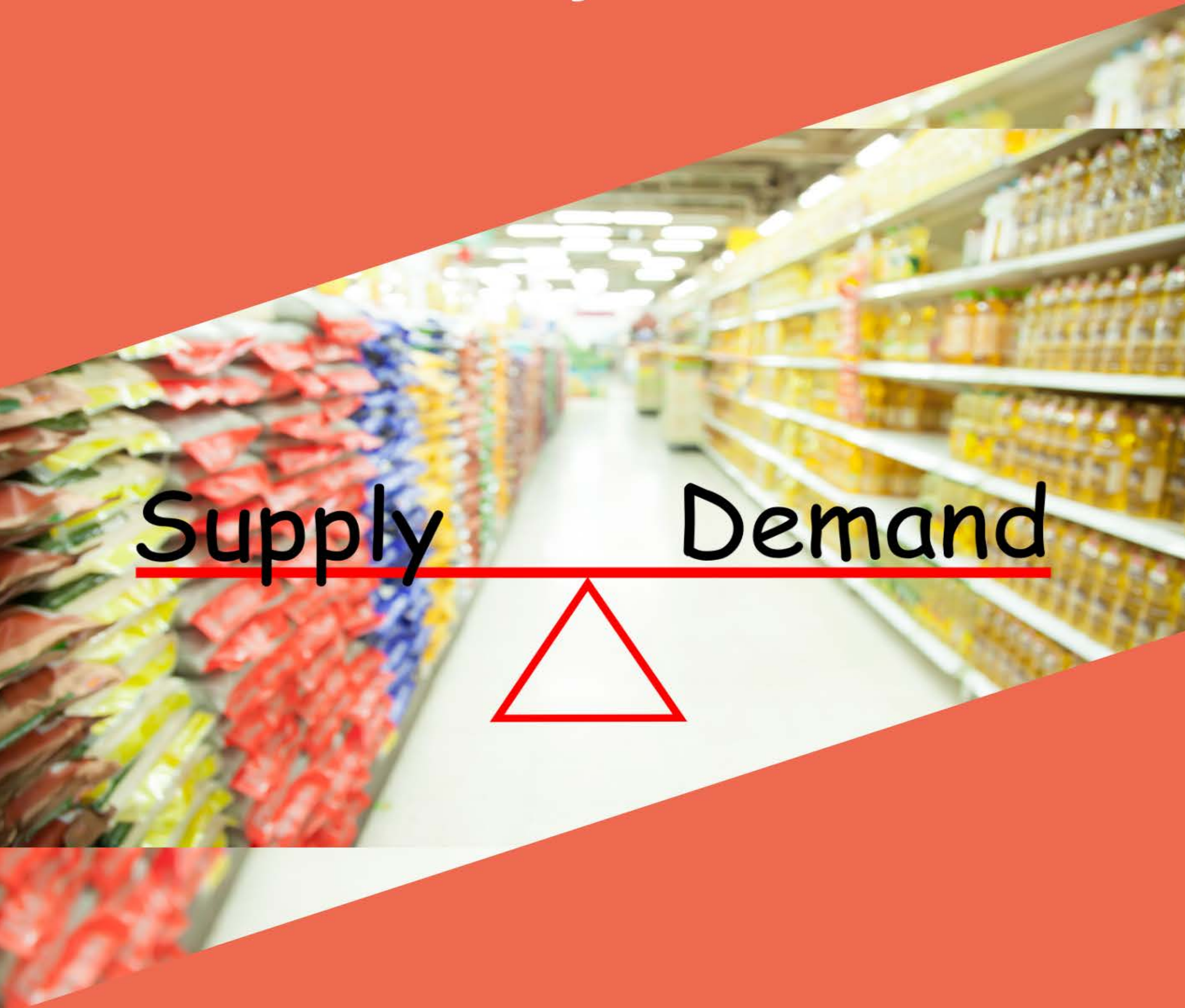
ECONOMICS 2

FOR

Senior Secondary School



AKADALEARN

FIRST TERM NOTES ON ECONOMICS

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FIRST TERM

WEEK 1

Topic– Distributive Trade

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1. **Meaning of distributive**
2. **Process of distribution**

Meaning of Distributive Trade

Distributive trade is defined as the totality of all forms of trade activities, from the procurement of goods from the manufacturer, to delivery these goods to the consumers. It includes wholesale and intermediation trade, retail and trade in motor vehicles and motorcycles trade

Distributive Trade is known as the chain of distribution. It is the various stages or channels through which finished goods are moved from the manufacturer to the final consumers.

The chain of distribution can be demonstrated by the following diagram

Process of distribution

The process of distribution of goods involves all human and physical means which aid the smooth transfer of goods from manufacturer/ producer to the final consumers

The following are the process of distribution

1. **Middlemen**: The middlemen are refers to has human factor involve in the distribution of goods to the final consumers; they are known as the wholesalers and retailers. They help in the relocation of goods from the manufacturer to the consumers. Their functions are:

- **Transportation**: This is the medium through which the finished goods are moved from one place to another either through air, land, water, or rail from the producer/ manufacturer to the consumer.

- **Advertisement**: advertisement is the means of creating awareness in the mind of the people about the existence of a particular product. Products are advertised through the radio, television, newspaper, magazine etc.
- **Warehousing**: warehousing is the process of storing goods till the time they will be needed for sale. It ensures there is a regular supply of goods at all time.

The wholesalers

The wholesaler is a person or a merchant who buys goods from the producer in large quantity and sells in small quantity to the retailers.

Functions of the wholesaler to the manufacturer

1. By selling under his own brand name the wholesaler often relieves the manufacturer of the need to advertise his product.
2. The wholesaler removes goods in larger quantities as they are produced, thus clearing the production lines
3. By warehousing the goods the wholesaler bridges the time gap between production and consumption, leaving the manufacturer free to concentrate on his specialized activities.
4. He eliminates the need for a marketing system with all that involves in terms of warehousing space, distribution network, sales staff, accounting records, and debt collection
5. By paying promptly the wholesaler reduces the working capital required by the manufacture.
6. The wholesalers provide the transportation system needed in the distribution of goods.

7. He bears the risk because he takes care of the goods and thereby accepts any responsibility of any loss of goods.
8. They also help to give advice to the producers
9. They render credit facilities by paying upfront before the goods are ready.

Functions of the wholesalers to the retailers

1. He chooses a convenient situation and opens at convenient hours.
2. The wholesaler breaks bulk to a reasonable size, selling in quantity but not large quantities.
3. He often helps the retailer to meet cut-price competition from the multiple shops and canine stores by selling to him at cut prices, providing the retailer is prepared to accept a reduction of services. This usually means 'cash and carry;' no credit is given, and the retailer transports the goods to his premises in his own van.
4. He gives credit to certain classes of retailer, thus reducing the amount of capital needed by the retailer.
5. In many cases the wholesaler operates a fleet of vehicles and delivers goods to the retailer as and when required.
6. By carrying stack which is readily available he reduces the capital and space required by the retailer. The retailer stocks only the goods that 'turn over' quickly. Slow moving items are ordered as required from the wholesaler.
7. The wholesaler displays a variety of goods from hundreds of manufacturer and demonstrates or displays them as necessary. At the warehouse the retailer can therefore see not only the lines he normally handles but the latest inventions and designs.

The Retailer

The retailer is a person who buys goods in small quantity from the wholesalers and sells in bits or unit to the final consumers. The retailer is an important middleman in the distribution of goods.

Characteristics of the retailers

1. The retailers sell directly to the final consumers
2. They sell in units and small quantities
3. They are the final link in the chain of distribution
4. Their wares consist of fast selling products i.e. consumer goods
5. Retailers stock and sell a wide variety of products.
6. They are very close to the consumer

Functions of the retailers

1. **Buying**

A retailer buys a wide variety of goods from different wholesalers after estimating customer demand. He selects the best merchandise from each wholesaler and brings all the goods under one roof. In this way, he performs the twin functions of buying and assembling of goods.

2. **Storage**

A retailer maintains a ready stock of goods and displays them in his shop

3. **Selling**

The retailer sells goods in small quantities according to the demand and choice of consumers. He employs efficient methods of selling to increase his sales turnover.

4. **Grading**

The retailer grades the goods which are not graded by manufacturers and wholesalers. He packs goods in small lots for the convenience of consumers..

5. **Risk bearing:**

A retailer always keeps stock of goods in anticipation of demand. He bears the risk of loss due to fire, theft, spoilage, price fluctuations, etc.

6. **Transportation**

Retailers often carry goods from wholesalers and manufacturers to their shops

7. **Financing:**

Some retailers grant credit to customers and provide the facility of return or exchange of goods. In some cases, home delivery and after sale service are provided by retailers.

8. Publicity

A retailer displays goods. He carries out publicity through shop decoration window display etc. he maintains personal and direct contact with consumers.

9. **Information**

Retailers provide knowledge to the consumers about new products and uses of products and uses of old products. They advice and guide consumers in better choice of goods. They also provide market information to wholesalers and manufacturers

Test and exercise

1. Top of Form——— is the various stages in which or channels through which finished goods are moved from the producers to the consumers is (a) distributive trade (b) trade development (c) distributive goods (d) all of the above. ans (a)
2. It is agreed that production is not complete until the goods get to the (a) producer (b) retailer (c) consumer (d) wholesalers

3. All of these are the functions of the wholesalers to the producer except (a) they help the producer in advertising product (b) they render credit facilities (b) they make goods available in units (d) they help in branding and packaging of goods. ans (b)
4. All the following are the process of distributive trade except (a) warehousing (b) transportation (c) the middlemen (d) the centre men. ans (d)
5. The middleman is refers to as (a) the producer (b) the consumers (c) human element involved in the distribution of goods (d) none of the above. ans (c)

WEEK 2

Topic– Distributive Trade. For previous lesson on Distributive Trade

Content–

1. **The middlemen**
2. **Advantages/disadvantages of the middlemen**
3. **The role of the cooperatives in distributive trade**
4. **The role of government in distributive trade.**

The middlemen

The middlemen are known as the wholesalers and the retailers who specialize in performing activities relating to the purchase and sale of goods in the process of their flow from manufacturer to final consumers or buyers.

Advantages/survival of the middlemen

The middlemen will continue to survive in the distributive trade because of their importance and functions to both the producer and retailers; these functions cannot be overemphasized.

Disadvantages/elimination of the middlemen

The Following disadvantages are some of the reasons a school of thought suggest the elimination of middlemen. They are

1. **Creation of artificial scarcity**: The wholesalers and retailers create artificial scarcity of goods through the process of hoarding.
2. **Misinformation**: Some of the middlemen who are not well trained can give wrong information to the produces or the consumers about a particular product.

3. **Increase in price**: The middlemen cause the rise in the prices of goods because they want to make profit and most times does that in an abnormal way.
4. **Longer channel of distribution**: The wholesalers and the retailers make the channel of distribution longer than necessary.

The role of co-operatives in distributive trade

A co-operative society is defined as the group of individuals with common interest who pool their resources together to promote the economic and welfare of their members in production, distribution and consumption of goods and services.

The producers and the consumers co-operative societies do engage in the distribution of products either directly from the manufacturers or wholesalers and sell to their members at reduced prices.

The following are the roles of cooperative societies in distributive trade

1. They help to bring the goods closer to their members
2. They give advice to their members on the use of goods or any product
3. They fight hording of the middlemen by buying directly from the producers and give to their members.
4. They help to grant credit facilities to their members so as to help them enjoy goods without immediate payment.
5. They buy and stock varieties of goods from the manufacturers, so they are exposed to different varieties of goods.
6. They also engage in assisting members to market their products.

Problems of distribution of commodities in West Africa

1. **Packaging problem**: The packaging of goods is not of a good standard, thereby leading to damages or loss of goods during the transit of the goods.
2. **Administrative bottlenecks in the collection and handling of goods:** excessive delay of supply and delivery of commodities is another problem that is common to West Africa in the area of distribution of goods.
3. **Inadequate storage**: lack of storage facilities and warehousing is another problem, it mostly affects perishable goods, and this can lead to scarcity immediately the harvest is over.
4. **Inadequate information**: The producers, sellers and buyers do not have sufficient information about the market.
5. **Long chain of distribution**: the effect of the middlemen in the chain of distribution makes the prices of goods to be increased
6. **Insecurity on our roads**: The condition of our roads is bad and the armed robbers on the road can cause a lot of danger in the process of distributing goods.
7. **Hoarding and speculation**: artificial scarcity can occur as a result of change in government policies, this disrupts the distributives process and increases price unnecessarily.
8. **Inadequate infrastructural facilities**: infrastructural facilities like good roads and good network system and good telephone system will help to fasten the distributive.

Test and exercise

1. The middlemen are majorly known as the ———– in the distribution of trade (a) the manufacturer and the producer (b) the consumers and the retailer (c) the consumer and the producer (d) the retailer and the wholesalers. ans (d)

2. ———- is defined as a voluntary and business organization in which a group of individuals with common interest pool their resources together to promote the economic welfare of their members (a) trade society (b) cooperative society (c) management society (d) regional society. ans (b)
3. All of these are problems of distribution of commodities in west Africa except (a) insecurity on our roads (b)hoarding and speculation (c) inadequate infrastructural facilities (d) adequate storage of products. ans (d)
4. One of the roles of the cooperative societies in the distribution of goods and services is (a) they help to exposed their members whenever there is no money to buy goods (b) they help to eliminate the activities of the middlemen by buying directly from the producers (c) they inflate the prices of goods to make profit (d) they do not grant credit facilities to their members. ans (b)
5. One major disadvantage of the middlemen is (a) they cause increase in the prices of goods (b) they cause decrease in the prices of goods (c) they brings good closer to the consumer (d) they sell in small quantities to consumers. ans (a)

Week 3

Topic– Wages

Content –

1. **Meaning of wages**
2. **Types of wage**
3. **Wage rate**
4. **Types of wage rate**
5. **Factors responsible for variation in wages**

Meaning of wages

Wages can be defined as the payment made by the entrepreneur to the labor for services rendered in the process of production. Wage is the reward for labor as later discussed in the factors of production. It is the reward paid for the service of a labor.

A **wage** is monetary compensation (or remuneration) paid by an employer to an employee in exchange for work done. Payment may be calculated as a fixed amount for each task completed (a *task wage* or piece rate), or at an hourly or daily rate, or based on an easily measured quantity of work done.

Types of wages

The following are the types of wages

1. **Nominal Wages:** this is also refers to as money wage, it is the total amount of money given to a particular labor for the work done at a particular period in time; it is paid in a monetary term.
2. **Real Wages**: It is the purchasing power of a labor, it is the total amount or quantity of goods and services a labor can use his/ her money can buy.

Wage rate

A wage rate is a regular payment, usually on an hourly, daily, or weekly basis, made by an employer to an employee, especially for manual or unskilled work.

It is defined as the rate at which a labor is paid for the services it renders in production.

Types of wage rates

1. **Time rate system**: This is the type of wage rate paid to laborers based on the number of hours worked, it basically applied to labors whose wages are paid hourly, daily or on monthly basis.

Situations where time rate system can be applied are

- Time rate is applied when the quality of work done is more important than quantity of work.
- when giving of incentives to workers is not necessary
- When the quantity of work done is not easy to measure
- When some certain jobs may not be done for a long period of time

2. **Piece rate system:** This is the wage paid to workers based on the work done i.e. workers are paid based on their output

Situations where piece rate system is applied

- Where incentives to workers is encouraged
- Where the outputs of workers can easily be measured
- Where the entrepreneur is expecting a large scale of production
- An organization where supervision may not be necessary.

Factors responsible for variation in wages

The following factors are responsible for differences in the wages paid to workers

1. **skills/training:** Jobs requiring higher level of skills and training usually fetch higher remuneration
2. **Education/qualifications:** Again jobs requiring higher level of education/qualification are paid higher remunerations.
3. **Experience:** People with vast experience will get higher remuneration as compared to a person with lesser experience.
4. **Level of responsibility:** Jobs with greater responsibilities are usually paid more.
5. **Geographical area:** Jobs located in urban areas are usually carrying higher remunerations because of higher living costs in cities. People working in treacherous geographical areas may get extra remuneration in the form of additional allowances.
6. **Trade union membership:** Trade Union members might end up negotiating better remunerations then non-trade union members.
7. **Demand factors:** Firms producing goods and services which are high in demand usually pay better remunerations to their workers.
8. **Level of risk associated with a job**: certain jobs like piloting, army or petroleum engineering are risky compare to some other jobs thereby making the salary of such to be high.
9. **Level of productivity**: A worker is paid more when there is high level of productivity, this is because the higher the productivity of a worker the higher the wages and vice versa

Test and exercise

1. ———- can be defined as the payment made to labor for the services they render in production. (a) Interest (b) premium (c) wages (d) rent. ans (c)

2. The following can help to determine the variation in wages except (a) geographical area (b) level of productivity (c) demand factors (d) All of the above. ans (d)
3. The type of wages that state the value of what the money can buy is (a) nominal wage (b) real wage (c) time rate system (d) piece rate system. ans (b)
4. The type of wage rate paid to labors based on the work done is (a) piece rate system (b) time rate system (c) nominal wage system (d) real wage system. ans (a)
5. Another word for nominal wage is (a) real wage (b) wage rate (c) money wage (d) sales wage. ans (c)

WEEK 4

Topic: Wage Determination

Content

1. **Meaning of Wage determination**
2. **Factors of Wage determination**

Meaning of Wage Determination

A "**wage determination**" is the listing of **wage** rates and fringe benefit rates for each classification of laborers and mechanics which the Administrator of Labor has determined to be prevailing in a given area for a particular type of construction.

It is also the process of setting wage rates or establishing wage structures in particular situations.

Wages can be determined through the following means

Factors of Wage Determination

1. The forces of demand and supply in a market economy: In a market economy, we mean a capitalism economy where every individual is allowed to participate in the production of goods and services thereby creating room for competition. In a competitive labor market there are so many employers and employees, so a single employer or employee cannot influence the wage rate. The wage rate in a competitive market can be determined by

- When the supply of labor exceeds the demand, wage rate will fall.
- When the demand for labor exceeds the supply, wage rate will rise.
- When the demand for labor equals the supply, wage rate will be favorable to both employer and employee.

2. Government activities and policies: The policy set by the government and her commissions determine the wages of labors especially in the public service. In fixing of wages the government agency or wage commission consider the following:

3. Level of productivity: The higher the level of production the higher the wage rate of workers.

4. Cost of living: The cost of living determine the wage rate, if workers spend so much to get the essentials of life, then the wage will have to increase to enable them meet up with their expenses

5. Type of occupation: wage structure vary from one occupation to another, the type of occupation will determine the wage received.

6. The activities of the trade union: A trade union is an association of workers formed to enable the members to take collective decision rather than individual decision. They take decision relating to their interest and conditions of work. Examples of trade union are National Union of Petroleum and Natural Gas Workers (NUPENG), National Union of Road Transport Workers (NURTW) National Labor Congress (NLC), Academic Staff Union of Universities (ASUU) etc.

Objectives of trade union

1. They secure employment for their members who do not have job.
2. They regulate the entry qualifications into the various professions
3. They make it their responsibility to safeguard the interest of their members.
4. They help to secure good wages for members.

Weapons that can be used by a trade union during a trade dispute.

The trade union as an association has some certain weapons they can use whenever there is a trade dispute. Some of these weapons are:

1. **Strike**: This is the situation where the workers stay out of work completely, it is the ultimate weapon used by most trade unions.
2. **Picket lines**: This is a situation where workers stays at the entrance of the factory and refuse to work.
3. **Collective bargaining**: This method the representative of the union and employers will meet to negotiate or deliberate on issues affecting the workers.
4. **Threat to strike**: This is when the workers give ultimatum to the employers that they will embark on strike if their demands are not met. It is like a threat to the employers.

Test and exercise

1. The major aim of the trade union is to (a) embarrass their employers when their needs are not met (b) to make decisions relating to their work (c) They discipline employers by fighting them (d) all of the above.
2. The process of setting wage rates or establishing wage structure in particular situations is known as (a) wage determination (b) wage consideration (c) wage implementation (d) wage allocation.
3. The weapon used by trade union where workers stays at the entrance of the factory and refuse to work is (a) strike (b) collective bargaining (c) threat to strike (d) picket lines.
4. All the following are weapons used by the trade union during a trade disputes (a) strike (b) picket lines (c) fighting and quarreling (d) collective bargaining.
5. ASSU stands for (a) All State Situation Union (b) Academic Staff Union of Universities (c) Academic Student State Union (d) All Students and Staff Unions.

WEEK 5

Topic: Market Structure

Contents

1. **Definition of market**
2. **Types of market**
3. **Perfect Market and imperfect market**

Meaning of Market

Market is a point of contact, place or any means of communication where sellers and buyers can communicate with one another, to exchange goods and services at a particular price.

It is a medium that allows buyers and sellers of a specific good or service to interact with order to facilitate an exchange. The price that individuals pay during the transaction may be determined by a number of factors, but price is often determined by the forces of supply and demand.

An actual or nominal place where forces of demand and supply operate, and where buyers and sellers interact (directly or through intermediaries to trade goods, services or contracts

A **market** is one of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange. While parties may exchange goods and services by barter, most markets rely on sellers offering their goods or services (including labor) in exchange for money from buyers.

It can be said that a market is the process by which the prices of goods and services are established. The market facilitates trade and enables the distribution and allocation of resources in a society. Markets allow any trade-able item to be evaluated and priced. A market emerges more or less spontaneously or may be constructed deliberately by human interaction in order to enable the exchange of rights of services and goods.

Types of market

Market can be categorized based on the type of commodities sold and purchased. They are:

1. Consumer goods market: Consumer goods market is the type in which finished goods ready for used by consumers are sold and bought.
2. Capital Market: It is a market for medium term and a long term loan; it serves the need of industries and the commercial sector.
3. Primary Products market: Primary products are the type of market in which primary products in their raw forms are sold and bought.
4. **Labour Market**: This is the type of market which workers and employers are in close contact for the purpose of rendering services.
5. **Stock Exchange market**: This is a market where investors can buy and sell existing securities like shares, stock, securities etc.
6. **Factor market**: This is the type of market in which the factors of production are sold and bought
7. **Money market**: It is a market where short term loan e.g bank.

Types of market according to channel of distribution

1. **Retail Market**: This is the type of market in which the traders known as retailer buys goods from the wholesalers and sell in unit to the final consumers.
2. **Wholesale market**: This is the market where people called wholesaler's buys goods in bulk from the producer and sell to the retailers in small quantities.

- Types of market according to prices: This is the type of market based on the prices of commodities are grouped into two, which are perfect and imperfect market.

PERFECT MARKET

Market structure characterized by a very large number of buyers and sellers of a homogeneous (no differentiated) product. Entry and exit from the industry is costless, or nearly so.
Information is freely available to all market participants, and there is no collusion among firms in the industry. It is difficult to identify a perfect market in reality; however, lumber and agriculture provide close approximations in the United States.

A perfect market is a market where the buyers or sellers cannot determine or influence the price of goods and services. It is known as a competitive market.

Characteristics/ conditions necessary for a perfect market

The following conditions/characteristic must be present for a perfectly competitive market structure to exist.

1. There must be *many firms* in the market, none of which is large in terms of its sales.
2. Free entry and exist: firms should be able to *enter and exit the market easily.*
3. Homogeneous product, each firm in the market produces and sells non differentiated or i.e goods sold must be identical, must be of the same shape, size, color etc.
4. Perfect knowledge: all firms and consumers in the market have *complete information* about prices, product quality, and production techniques.
5. Common price: In a perfect Market, the commodity sold must have the same price throughout the market.

6. Portable goods: The goods sold must be easy to carry from one place to another,
7. No preferential treatment: All buyers must be treated equally; sellers are not allowed to show favoritism in the process of selling of goods.
8. Easy transfer of factors of production: In a market like this, factors of production can easily be transferred to places where they are needed.
9. Large buyers and sellers: The number of sellers and buyers are high and therefore no one has the ability to influence the prices of goods and services.

Test and exercise

1. A market where buyers and sellers cannot influence the prices of goods and services is referred to as (a) imperfect market (b) retailer market (c) wholesaler market (d) perfect market.
2. A point of contact, place or any means of communication where sellers and buyers transact business is (a) market (b) village (c) Town (d) abroad.
3. All are the conditions for a perfect market except (a) large buyers and sellers (b) homogeneous product (c) there is preferential treatment (d) portable goods.
4. Type of market where medium term loan and long term loan are sold is called (a) factor market (b) capital market (c) labor market (d) capital market.
5. The market where goods are sold in small quantities to retailer is called (a) wholesale market (b) producer market (c) retailer market (d) capital market

WEEK 6

Topic: Market Structure.

Content

1. **Imperfect Market**
2. **Conditions necessary for imperfect market**
3. **Types of imperfect market**
4. **Monopolistic Competition.**

Imperfect Market: An imperfect market is defined as the market in which prices of goods and services can easily be influenced by the sellers or buyers.

Imperfect market is also called imperfect competition. It is a market where information is not quickly disclosed to all participants in it and where the matching of buyers and sellers isn't immediate. Generally speaking, it is any market that does not adhere rigidly to perfect information flow and provide instantly available buyers and sellers.

Imperfect competition is a competitive market situation where there are many sellers, but they are selling heterogeneous (dissimilar) goods as opposed to the perfect competitive market scenario. As the name suggests, competitive markets that are imperfect in nature.

Conditions for imperfect market

The conditions necessary for imperfect market are opposite to the conditions for a perfect market. These conditions are:

1. There are few buyers and sellers
2. The goods are not homogeneous i.e. they are not similar
3. There is no common price

4. There is difficulties in the transfer of the factors of production
5. There is no free entry and free exit
6. There is no perfect information
7. There use to be preferential treatment
8. Goods sold are not portable.

Types of imperfect market

1. **Monopoly**– It is an imperfect market in which there is a single seller of a particular good or service.It is a situation in which a single owner owns all or mainly all of the market for a particular kind of product or service. There exist a barrier to exit and a barrier to entry in this kind of a market. In such an industry structure, the producer will often produce a volume that is less than the amount which would maximize social welfare.

Characteristics of monopoly market·

- Single Seller
- Price Discrimination
- Homogenous Product
- No entry of New Seller **Determination of Monopoly Equilibrium**
- Firm will have excess profits if P > ATC
- If no new entry of other firms selling substitute goods excess profit can remain
- Idea of "full equilibrium" where other firms come in and all firms are where MC =MR and P = ATC but each firm still facing a downward sloping demand curve

2. **Monopolistic Competition**: A market framework in which a number of or so many sellers each make alike, but to some extent

distinguish goods. Each manufacturer can put its MRP and capacity devoid of disturbing the market place as a whole.

Characteristics of Monopolistic Competition

- Many Sellers
- Free entry in the market
- Prize change to capacity of seller
- Differentiate Product. Determination of equilibrium
- Equilibrium for the a single firm is where MR (derivates from the demand curve) = MC
- For all this to remain steady with equilibrium for the cluster the firm should also be on its contribute of the market demand curve
- In the time-consuming run all firms must just be building ordinary profits coz of open admission provision

3. **Oligopoly**: It is a type of imperfect market where there are few producers or sellers of the same commodity. A market conquered by a tiny amount of contestants who are capable to jointly apply control over market prices and supply.

Characteristics of Oligopoly·

- Few sellers (may be three, four etc).
- Homogenous product
- without charge admission in market

4. **Monopsony**: This is the type of market where is only one buyer for a product
5. **Duopoly**: This is when there are just two producers of the same product

Causes of monopoly

The following are the causes of monopoly market. These are

1. Natural cause: Some people enjoy the production or supply of certain Niger Delta.
2. Level of technology: When an organization has a high level of technology which makes him to produce more goods at a low cost and therefore sells good at a very low cost, it can make other firms to close down their operation.
3. Effective advertisement: The success of a firm in effective advertising may force other competitors out of business
4. Patent Law: This is the law that is confers on a firm special privilege to protect its invention and this scare people away.
5. Protection of public interest: Deliberate effort to protect the interest of the public by government can confer monopoly on some firms e.g Power Holding Company of Nigeria.(PHCN)

Advantages of Monopoly

1. There is avoidance of duplication
2. It leads to invention
3. There is standardization of goods
4. There is greater efficiency
5. There is increase in supply
6. There is greater opportunity to expand operation
7. There is Economies of large scales
8. There is centralized management
9. There is better use of resources

Disadvantages of monopoly

1. It leads to hoarding of goods
2. There could be over production and wastage
3. Decline in efficiency because there is no competition
4. Loss of freedom of choice
5. Danger of exploitation.

Control of Monopoly

Ways by which Monopoly can be controlled are:

1. The stoppage of the issuance of patent law
2. Privatization
3. Provision of substitute product.

Test and Exercise

1. The market where the buyers and sellers can influence the prices of goods and services is (a) perfect market (b) imperfect market (c) capital market (d) labor market.
2. One of these is a condition for an imperfect market (a) free entry and exit (b) knowledge of the market (c) there is no common price (d) goods are portable.
3. A type of imperfect market where there are only two producers of the same product is (a) monopoly (b) monopolistic competition (c) monopsony (d) duopoly.
4. One of the ways by which a monopoly can be controlled is (a) Provision of substitute product (b) continuance of giving patent law (c) government refusal to confer any special monopoly on any firm (d) all of the above.

5. All can cause monopoly except (a) natural cause (b) patent law (c) level of technology (d) provision of substitute product.

WEEK 7

Topic: Inflation

Content

1. **Meaning of Inflation**
2. **Types of inflation**
3. **Causes of inflation**
4. **Effects of inflation**

Meaning of Inflation

Inflation can be defined as the persistent rise in the general price level of goods and services.

Inflation is the rate at which the general level of prices for goods and services is rising, and, subsequently, purchasing power is falling.

Inflation occurs when the volume of purchases is permanently running ahead of production and too much money in circulation chasing fewer goods. In economics **inflation** is a sustained increase in the general price level of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy. A chief measure of price inflation is the inflation rate, the annualized percentage change in a general price index (normally the consumer price index) over time.

Types of Inflation

There are three main types of inflation. These are:

1. **Demand pull inflation**: Demand pull inflation occurs when consumers have high purchasing power leading to increases in

aggregate demand without a corresponding aggregate supply. This type of inflation occurs when the demand for goods and services is greater than their supply. This arises as a result of increase in population or increase in workers' salaries

2. **Cost Push inflation:** Cost push inflation occurs when increases in cost of production are passed on to the consumers through increase in price of goods and services sold. This is when there is increase in the prices of goods due to the increase in the cost of production.
3. **Hyper Inflation**: This is also known as galloping or runaway inflation, it occurs when a persistent inflation becomes uncontrollable and the value of money keeps declining rapidly. This type of inflation can be caused by war or budget deficit.
4. **Persistent or creeping inflation**: Persistent or creeping inflation is also known as chronic inflation, it occurs when there is a slow but steady rise in the volume of purchasing power and a fall in supply of goods and services

Causes of Inflation

The following are the causes of inflation

1. **Low Production**: Low production of goods and services can lead to their scarcity and when supply cannot meet up with the demand, inflation will set in.
2. **War**: War is a major cause of inflation as it will stop people from producing therefore resulting in high volume of money purchasing fewer goods.
3. **High cost of production**: when the cost incurred for the production of goods and services is high, the cost of selling will be high so that the producer can make profit; which leads to cost push inflation.
4. **Budget deficit**: When government expenditure is more than its income, it results in budget deficit and this lead to inflation.

5. **Population increase**: A sudden rise in the population will result in a corresponding rise in the demand for goods and services and if there is no corresponding increase in the supply of goods there will be inflation.
6. **Money laundering**: when there is too much money released or injected into the economy, the prices of goods will increase and therefore lead into inflation.
7. I**nadequate storage facilities**: When goods produced cannot be stored for future use, it can lead to scarcity resulting in inflation.
8. **Level of importation:** High cost of importing raw materials can lead to high cost of goods which is passed to consumers leading to cost- pull inflation.

Effects of inflation

Inflation has both negative and positive effect

The Positive effects of inflation are

1. It brings about higher profit margin for the sellers of goods and services
2. It yields higher tax rate for the Government
3. It encourages higher output from the producers
4. There will reduction in the burden of debt because there is too much money in circulation

The Negative effects of inflation are

1. There will be loss in the value of money
2. It discourages investors from investing
3. It discourages savings because people spend more to purchase goods and services.

4. It discourages exportation
5. It creates balance of payment problems
6. It brings a fall in standard of living
7. Creditors will loose
8. Income redistribution; there will be a fall in real income especially pensioners and fixed salary earners.

Control of inflation

Ways by which inflation can be controlled are the following

After experiencing inflation of 50% plus in the mid 1990s, inflation in Nigeria is currently 7.9% in November 2014.

With these statistics, we can consider ways that inflation could be reduced.

1. **Monetary Policy**

With growth of 3.8%, demand in the economy could be growing faster than capacity can grow to meet it. This leads to inflationary pressures. We can term this demand pull inflation. Therefore, reducing the growth of Aggregate demand should reduce inflationary pressures.

The Central bank could increase interest rates. Higher rates make borrowing more expensive and saving more attractive. This should lead to lower growth in consumer spending and investment. A higher interest rate should also lead to higher exchange rate, which helps to reduce inflationary pressure by

- making imports cheaper
- Reducing demand for exports and
- Increasing incentive for exporters to cut costs.

Interest rates were increased in the late 1980s / 1990 to try and control the rise in inflation

2. Fiscal Policy

The government can increase taxes (such as income tax and VAT) and cut spending. This improves the budget situation and helps to reduce demand in the economy.

Both these policies reduce inflation by reducing growth of Aggregate Demand. In Nigeria's case, the economy seems to be growing reasonably strongly. Therefore, we can reduce inflationary pressures without causing a recession.

If Nigeria had high inflation and negative growth, then reduce aggregate demand would be more unpalatable as reducing inflation would lead to lower output and higher unemployment. They could still reduce inflation, but, it would be much more damaging to the economy.

Other Policies to Reduce Inflation

1. **Wage Control**

If inflation is caused by wage inflation (e.g. powerful unions bargaining for higher real wages), then limiting wage growth can help to moderate inflation. Lower wage growth helps to reduce cost push inflation, and helps to moderate demand pull inflation.

However, as the UK discovered in the 1970s, it can be difficult to control inflation through incomes policies, especially if the unions are powerful.

This seeks to control inflation through controlling the money supply. Monetarists believe there is a strong link between the money supply and inflation. If you can control the growth of the money supply, then you should be able to bring inflation under control. Monetarists would stress policies such as:

- higher interest rates (tightening monetary policy)
- reducing budget deficit (deflationary fiscal policy)
- Control of money being created by government

1. Discouragement of importation: Government should discourage the importation of goods from countries that are experiencing inflation.
2. The use of income policies: The use of income policies such as wage freeze, delay in promotion etc. is also a way of controlling inflation.
3. Increase in Production: Inflation can be reduced in increasing the level of production or output in order to bring down the prices of goods.
4. Granting of subsidy to enterprises: through the granting of subsidies to enterprise and companies producing essential products to reduce the cost of production and the product prices.

Terminologies associated with inflation

1. Disinflation: A slowing in the rate of price inflation. Disinflation is used to describe instances when the inflation rate has reduced marginally over the short term. Although it is used to describe periods of slowing inflation, disinflation should not be confused with deflation. /the essence of disinflation is to control inflation by direct by direct control of consumer expenditure.
2. Spiral Inflation: It is a cycling of worsening inflation as higher prices result in higher wages, increase in cost and resulting in higher prices.
3. Inflationary gap: A description of a condition that arises in an economy of the difference between a country's real gross domestic product (GDP) and the level of GDP with full employment in the economy. The inflationary gap is so named because a rise in the level of an economy's GDP will cause an increase in consumption leading to higher prices. It is a economic situation where the total demand in the economy exceeds the total supply of goods and services available to satisfy demand
4. Reflation: is the act of stimulating the economy by increasing the money supply or by reducing taxes, seeking to bring the economy

(specifically price level) back *up* to the long-term trend, following a dip in the business cycle. It is the opposite of disinflation which seeks to return the economy back *down* to the long-term trend. It is an economic state of affairs in which prices, employment, output etc. are picking up again as a result of government policy to that effect.

5. Slumpflation: It is a state or period of combined economic decline and rising inflation. Slump inflation is marked by the idleness and underutilization of resources as capital and labor at the same time as the general price level is rising and the value of money falling.
6. Stag-inflation**:** is a term used in economics to describe a situation where the inflation rate is high, the economic growth rate slows down, and unemployment remains steadily high. It refers to high increases in the price level which are not accompanied by any increases in industrial production.

Test and Exercise

1. The persistent rise in the prices of goods and services is (a) inflation (b) slumpflation (c) deflation (d) hyper inflation.
2. The followings are the ways by which inflation can be controlled except (a) decrease in production (b) use of fiscal policy (c) wage control (d) monetarism.
3. One of the positive effect of inflation is (a) It discourages savings (b) Higher tax yield (c) fall in the standard of living (d) loss of value of money.
4. All the following can bring about inflation except (a) war (b) high production (c) low production (d) budget deficit.
5. The type of inflation that occurs when there is increase in the cost of production and is passed to consumers in form of high price is (a) demand pull inflation (b) hyper inflation (c) cost- push inflation (d) persistent or creeping inflation.

Week 8

Topic: Deflation

Content:

1. **Meaning of deflation**
2. **Causes of deflation**
3. **Effects of deflation**
4. **Control of deflation**

Meaning of Deflation

It is a general decline in prices, often caused by a reduction in the supply of money or credit.
It is defined as the continuous or persistent fall in the price level of goods and services as a result of the decrease of money in circulation. Deflation can be caused also by a decrease in government, personal or investment spending. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression.
Central banks attempt to stop severe deflation, along with severe inflation, in an attempt to keep the excessive drop in prices to a minimum.

Causes of Deflation

The following points below are the causes of deflation

1. **Increase in bank rate**: This helps to discourage commercial banks from borrowing from the central bank and by so doing reduces the bank's ability to lend money, leading to a reduction in money circulation.
2. **Increase in taxation**: When taxation is increased, it will definitely reduce the volume of money in circulation thereby causing deflation to occur.

3. **Budget surplus**: It is a device by which the rate of injecting money into the circulation was reduced.
4. **Increase in production**: Consistent increase in the production of goods without a corresponding increase in the circulation of money will lead to deflation.

Effects of Deflation

The following are the effects of deflation

1. It results into unemployment: Deflation brings about unemployment in the labor market.
2. Reduction in investment
3. Decline in profits
4. It encourages savings
5. Fixed income earners gain
6. It brings about increase in the value of money
7. It will bring about fall in the prices of goods and services.
8. It encourages exports
9. It discourages imports.

Control of Deflation

Deflation can be controlled in the following ways

1. **The use of open market operation**: This occurs when the central bank purchases securities from commercial banks, this makes it possible for the commercial banks to be able to lend money out and increase the volume money on circulation.
2. **The use of deficit budgeting**: An increase in government expenditure helps to inject more money into circulation by curbing the effects of deflation.

3. **Reduction in bank rate**: Reduction in bank rate will help to assist investors to borrow more money from banks thereby increasing the volume of money in circulation.
4. **Increase in wages and salaries**: This will help to inject more money into circulation thereby controlling deflation.
5. **Reduction in Taxation**: Reduction will help to have more money thereby increasing their purchasing power and controlling deflation.

Test and Exercise

1. The consistent and persistent fall in the price of goods and services is (a) inflation (b) deflation (c) reflation (d) disinflation.
2. The causes of deflation are except (a) increase in taxation (b) budget surplus (c) increase in bank rate (d) increase in demand.
3. Deflation can be controlled by (a) Reduction in taxation (b) increase in taxation (c) use of open market operation (d) increase in wages and salaries.
4. The following are effect of deflation (a) It results into employment (b) creditors gain (c) reduction in investment (d) encourages import.
5. Inflation and deflation can actually be controlled. True/ false.

WEEK 9

Economic analysis

Introduction

Economic analysis has to do with systematically determining the right ways to optimally utilize scarce resources. In this vein therefore, it involves (among other things) the comparison of two or more alternatives in achieving a specific objective under the given assumptions and constraints. Economic analysis also takes into account the opportunity costs of resources employed and attempts to measure in monetary terms the private and social costs and benefits of a project to the community or economy. A number of tools are usually employed when making economic analysis. And for the sake of this lesson, we shall be looking at the measures of central tendency.

The Measures of Central Tendency

There are three main ***Measures of Central Tendency*** namely- Mode, Median and Mean. Each of these measures describes a different indication of the typical or central value in the distribution. The mode is the most commonly occurring value in a distribution. Let us now look at each of these measures separately below-

The Mode

The Mode is said to be the most commonly occurring value in a distribution. And Distribution (or statistical distribution as it is called) is the description of the relative numbers of times each possible outcome will occur in a number of trials. For greater understanding,

Kindly consider the dataset below which shows the retirement age of eleven people in whole years:

54, 54, 54, 55, 56, 57, 57, 58, 58, 60, 60

This table shows a simple frequency distribution of the retirement age data

Age	**Frequency**
54	**3**
55	**1**
56	**1**
57	**2**
58	**2**
60	**2**

Note that the most commonly occurring value in the set is 54. Therefore, the mode of this distribution is 54 years.

Advantages of the Mode

The mode has an advantage over the median and the mean as it can be found for both numerical and categorical data; with categorical data being non-numerical data.

Disadvantages of the Mode

Economists often encounter some limitations when using the mode. In some *distributions*, the mode may not reflect the centre of the distribution very well. When the distribution of retirement age is ordered from lowest to highest value, it is easy to see that the centre of the distribution is 57 years, but the mode is lower, at 54 years.
54, 54, 54, 55, 56, 57, 57, 58, 58, 60, 60

It is also possible for there to be more than one mode for the same distribution of data, (bi-modal, or multi-modal). The presence of more than one mode can limit the ability of the mode in describing the centre or typical value of the distribution because a single value to describe the centre cannot be identified. In some cases, particularly where the data are continuous, the distribution may have no mode at all (i.e. if all values are different). In cases such as these, it may be better to consider using the median or mean, or group the data in to appropriate intervals, and find the modal class.

The Median

The Median is defined as the *middle value* in distribution when the values are arranged in ascending or descending order.
The median divides the distribution in half (there are 50% of observations on either side of the median value). In a distribution with an odd number of observations, the median value is the middle value.

Looking at the retirement age distribution (which has 11 observations), the median is the middle value, which is 57 years:

54, 54, 54, 55, 56, 57, 57, 58, 58, 60, 60

When the distribution has an even number of observations, the median value is the mean of the two middle values. In the following distribution, the two middle values are 56 and 57, therefore the median equals 56.5 years:

52, 54, 54, 54, 55, 56, 57, 57, 58, 58, 60, 60

Advantage of the Median
The median is less affected by outliers and skewed data than the mean, and is usually the preferred measure of central tendency when the distribution is not symmetrical.

Disadvantages of the Median
The median cannot be identified for categorical nominal data, as it cannot be logically ordered.

The Median

The Median is the sum of the value of each observation in a dataset divided by the number of observations. This is also known as the arithmetic average.
Looking at the retirement age distribution again:
54, 54, 54, 55, 56, 57, 57, 58, 58, 60, 60
The mean is calculated by adding together all the values
(54+54+54+55+56+57+57+58+58+60+60 = 623)
And dividing by the number of observations (11) which equals 56.6 years.

Advantage of the Mean
the mean can be used for both continuous and discrete numeric data.

Disdvantages of the Mean

The mean cannot be calculated for categorical data, as the values cannot be summed.
As the mean includes every value in the distribution the mean is influenced by outliers and skewed distributions.

ASSESSMENT

1. What is economic analysis?
2. What are the measures of central tendency?
3. What is mode and what are the advantages and disadvantages?
4. What is median and what are the advantages and disadvantages?
5. What is median and what are the advantages and disadvantages?

Week 10

What is the Theory of Consumer Behavior all about?

INTRODUCTION

The theory of consumer behavior is based on the principle assumption that consumers attempt to allocate their limited money to available goods and services so as to maximize their utility (satisfaction). The theory specify that consumers have the full understanding of all the available commodities and their prices, as well as how much disposable income required of them the consumers. Also, consumers must be able to do the needful comparisons with the different levels of satisfaction of various products (which they could buy from their incomes) so as to attain their highest level of satisfaction.

The Concept of Utility

Utility can be defined as the satisfaction derived from the purchase of a particular commodity. It is the satisfaction that a consumer derives from consuming a particular commodity or services at a particular period of time . It should be noted that any commodity or service that possess utility is useful to the consumer, commodities or services that are not useful to the consumers has no utility i.e no satisfaction. The usefulness of a commodity is a relative term because what is useful to Mr A might not be useful to Mr B. Utility depends on time, place and form to be able to satisfy human wants.

Types of Utility

Form Utility: Form utility can be defined as the change in the form of or structure of a commodity during its manufacturing process in other to increase its utility. Example: Cotton in its raw form cannot give satisfaction until it is for ed into a clothing material.

Place Utility: This involves the changing of location of of a commodity from one geographical place where it has no little utility to another location where its utility is higher. For example , cattle is mainly reared in in the North where it has little utility but transported to to the south where it has more demand.

Time Utility: This refers to the satisfaction a consumer derives for the consumption of a particular commodity at a given time. All goods produced do not give satisfaction at the same time, some products have to be stored and released later in order to create higher utility on them, especially when their prices increase.

Concepts of Total, Marginal and Average Utility

The Total Utility (TU): Total utility refers to the total amount of satisfaction a consumer derives from the consumption of a commodity at a particular time. It is the total amount of satisfaction derived from all the units of a commodity consumed at a particular time.

Total utility can be calculated by this formula: Total Utility (TU)= Average utility x quantity demanded

Law of Diminishing Marginal Utility

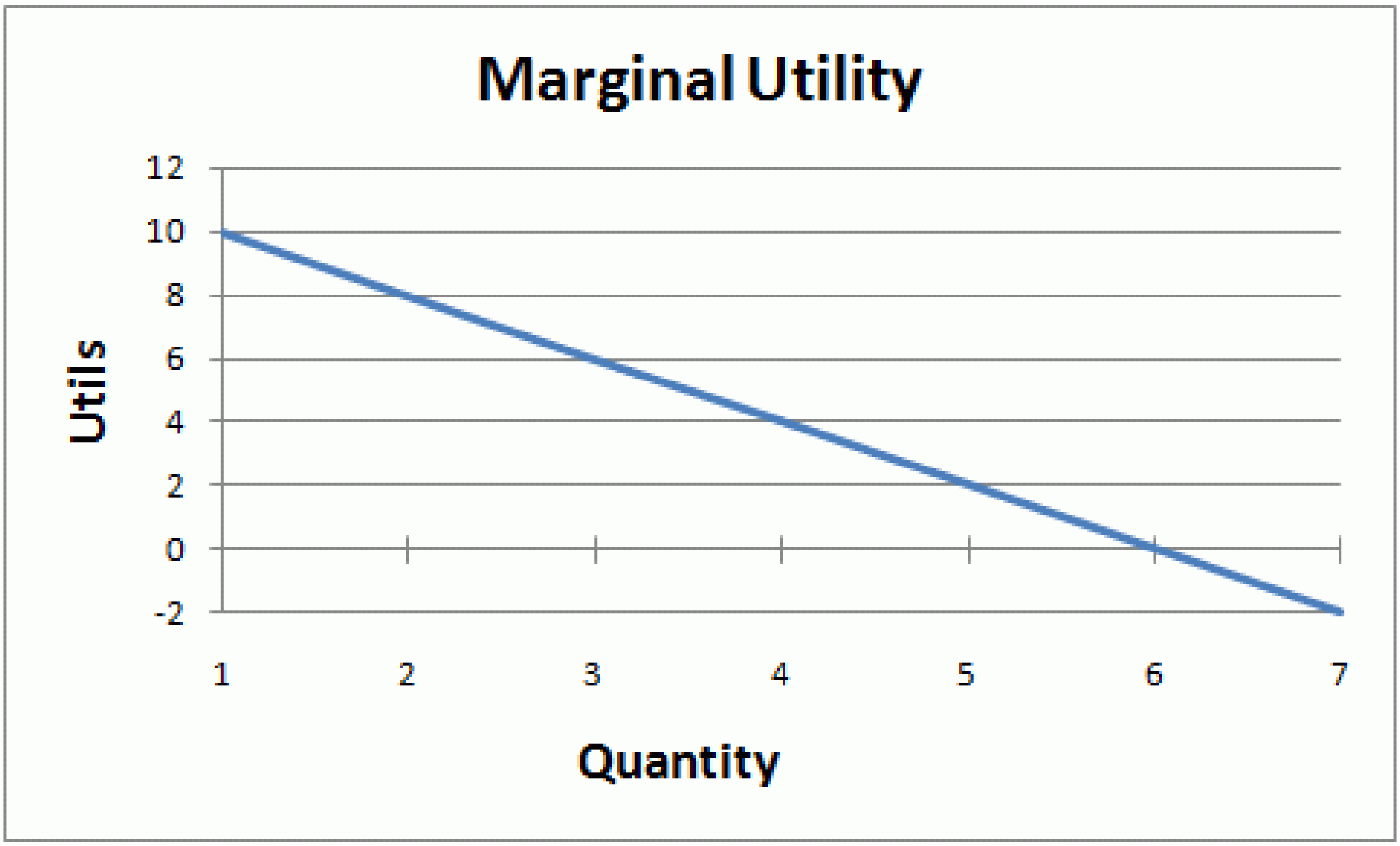
From the economists' point of view, the law of diminishing marginal utility means that the first unit of the consumption of a product or service produces more utility than the second and subsequent units, with a continuing reduction for higher amounts.

The marginal decision rule states that a product or service should be consumed at a quantity in which the marginal utility is the same as the marginal cost.

Total Utility curve

Marginal Utility: Marginal utility is the additional satisfaction derived by consuming an extra unit of commodity. It measures the extent to which the consumer's total satisfaction would be increased if he went ahead to consume one additional unit of the commodity.

The formula for calculating marginal utility (MU)= Change in TU



Marginal utility curve

Average Utility (AU): Average utility is the satisfaction which a consumer derives per unit of a commodity consumed. Average utility is calculated by this formula

AV= TU

Quantity Demanded

Average Utility Curve

Relationship between Total Utility and Marginal Utility

There is a unique relationship between total utility (TU) and marginal utility (MU). Their relationship can be summarised in the following ways:

1. The marginal utility begins to fall right after the first unit of the commodity has been consumed and continues to diminish until he reaches zero and below. Total utility increases right from the first unit consumed although the increase is small for every extra unit consumed.

2. At the point where the marginal utility reaches zero,i.e where the MU curve cuts the X-axis, total utility reaches its maximum point . This point is called saturation point.

3. When the marginal utility becomes negative, total utility begins to fall and when the MU curve descends below the x-axis, the TU curve begins to slope downwards. This relationship between TU an MU is explained

Test and Exercise

1. Define Utility
2. Discuss types of utility
3. Briefly describe the relationship between total utility and marginal utility
4. Explain with the aid of diagram (Total Utility, Marginal Utility and Average Utility)

The concept of ***Demand and Supply*** is perhaps one of the most fundamental concepts of economics. In other words, it is the backbone of a market economy. Demand refers to how much (quantity) of a product or service is desired by buyers. Specifically, it can be defined as the ability and willingness of a customer to buy a specific quantity of goods or services at a given price and at a particular period of time. With this definition, we can see an unavoidable relationship between price and the quantity demanded. This relationship is known as the ***demand relationship***. Supply represents how much the market can offer.

It is important to note that demand is not the same as ***want*** or ***desire*** because want or need is defined as just a mere desire for a commodity but not backed up by the willingness to ability to pay for that commodity at the same time. To differentiate demand from want we call it effective demand; this is a situation where desire is backed up by the ability and willingness to pay for specific quantities of a commodity at alternative prices within a period time.

Law of Demand

The law of demand states all things being equal, that the higher the price , the lower the quantity of goods that will be demanded ; or the lower the price, the higher the quantity of goods that will be demanded. This law is regarded as the first law of demand and supply; it means when the price of a commodity like beans for instance is high in the market and the price of rice is low, more people will demand for rice and less of beans.

This law holds under the following assumption

- That the consumer's income remain constant
- That no close substitutes of a commodity exist
- That the habits of the consumer remain the same
- That there will be no change in taste and preference of the consumer

The Law of Supply

Like the law of demand, the law of supply demonstrates the quantities that will be sold at a certain price. But unlike the law of demand, the supply relationship shows an upward slope. This means that the higher the price, the higher the quantity supplied. Producers supply more at a higher price because selling a higher quantity at a higher price increases revenue.

Demand Schedule

Demand schedule can be defined as a table showing the relationship between prices and the quantity of that commodity demanded. Demand schedule is of two types. Which are individual and market demand schedule.

Individual demand schedule: This is the table that shows the different quantities of a commodity which an individual or consumer would purchase at various prices and at a particular time.

Market demand schedule: It is known as the aggregate or total demand or composite demand schedule, it is the schedule of all consumers of a commodity in a market

Mr. Adelabu's demand schedule for cups of rice

Price Per Cup of Rice (naira)	Quantity demanded per week
300	5
250	10
200	15
150	20
100	25

50	30

The demand schedule above shows the relationship between the various prices of cup of rice and the quantity Mr Adelabu is willing to buy at each price per week.

Demand Curve

Demand curve is defined as a graph showing the relationship between the price and quantity of a commodity demanded. It is a diagrammatic representation of a demand schedule.

Types of Demand

1. **Joint or complementary demand**: This is the demand which occurs when two commodities that are related to each other are demanded at the same time. The commodities are said to be complementary to each other as a change in the demand of other will cause a change in the demand of the other commodities. Example of joint or complementary demand is bread and butter, car and petrol.
2. **Derived Demand**: Derived demand is the one that occurs as a result demand for other commodities. Example: the demand for flour and sugar to meet the demand for bread. The demand for pen and book to meet the demand of a student.
3. **Composite Demand**: A composite demand is the demand which is required to serve two or more purposes. Example: The demand of flour can be used for baking bread, baking cake, for making snacks etc. Therefore if there is a high supply of flour there will also be a high demand for it.
4. **Competitive Demand**: When two commodities are fairly close substitutes to each other, they are competitive demand, demand that serves the same purpose or similar function. Here, the high demand for one will bring a fall in the demand for the other. Examples of commodities with competitive demand are coca cola, fanta, pepsi, sprite. Milo, Bournvita, ovaltine etc

Change in Quantity Demanded/Change in Demand

In economics the terms change in quantity demanded and change in demand are two different concepts. Change in quantity demanded refers to change in the quantity purchased due to increase or decrease in the price of a product. In such a case, it is incorrect to say increase or decrease in demand rather it is increase or decrease in the quantity demanded.

On the other hand, change in demand refers to increase or decrease in demand of a product due to various determinants of demand, while keeping price at constant. Changes in quantity demanded can be measured by the movement of demand curve, while changes in demand are measured by shifts in demand curve. The terms, change in quantity demanded refers to expansion or contraction of demand, while change in demand means increase or decrease in demand

Change in Quantity Supplied/Change in Supply

If the supply of a commodity changes due to change in its price, it is called change in quantity supplied. On the other hand, if the quantity of a commodity changes due to factors other than the price of the commodity, we call it change in supply. The change in quantity supplied can be of two types. When the quantity supplied falls due to the fall in the price of a commodity, it is termed as contraction of supply. Here, supply contracts as a result of the fall in the price of the commodity.

Similarly, when the quantity supplied rises due to rise in the price of the commodity, it is called extension of supply. Here, supply extends as a result of rise in the price of the commodity. In both the cases, the law of supply applies. Thus, the change in quantity supplied is the result of changes in price of the commodity in question, other things remaining constant.

Meanwhile, Change in Supply has to do with increase or decrease in supply.   The change in supply can be of two types. When the quantity of a commodity rises due to factors (other than price of the commodity in question) like an innovation or the discovery of a cheap raw material, use of better techniques, decrease in prices of other commodities, fall in excise tax, expectations of fall in the price of the commodities in future, etc., it is termed as increase in supply.

Increase in supply implies a rightward shift of the supply curve, showing that producers are willing to supply more at each price (or same quantity at a higher price). It is shown by shift in curve from SS to S'S' in Fig. 3.4.

On the other hand, when the quantity of commodity supplied falls at the same price, it is referred to as a decrease in supply.

Effect of Change in Demand and Supply on Equilibrium Price and Quantity

As you can see, an increase in demand causes the equilibrium price to rise. On the other hand, a decrease in demand causes the equilibrium price to fall. An increase in supply causes the equilibrium price to fall, while a decrease in supply causes the equilibrium price to rise.

Well, as it turns out, I'm thinking about chocolate chip cookies right now. For some reason, talking about macroeconomics really increases my demand for cookies. Ever since they removed the Cookie Monster from public television's 'Sesame Street,' I've noticed a remarkable decrease in the supply of cookies in my house; however, my demand for cookies has only gone up and up and up! So, let's look at an example of equilibrium in the cookie market and see what happens when things change.

Test and Exercise

1) Define demand
2) Differentiate between demand and want
3) Explain the various types of demand with Examples
4) State law of demand
5) Define demand

Week 10

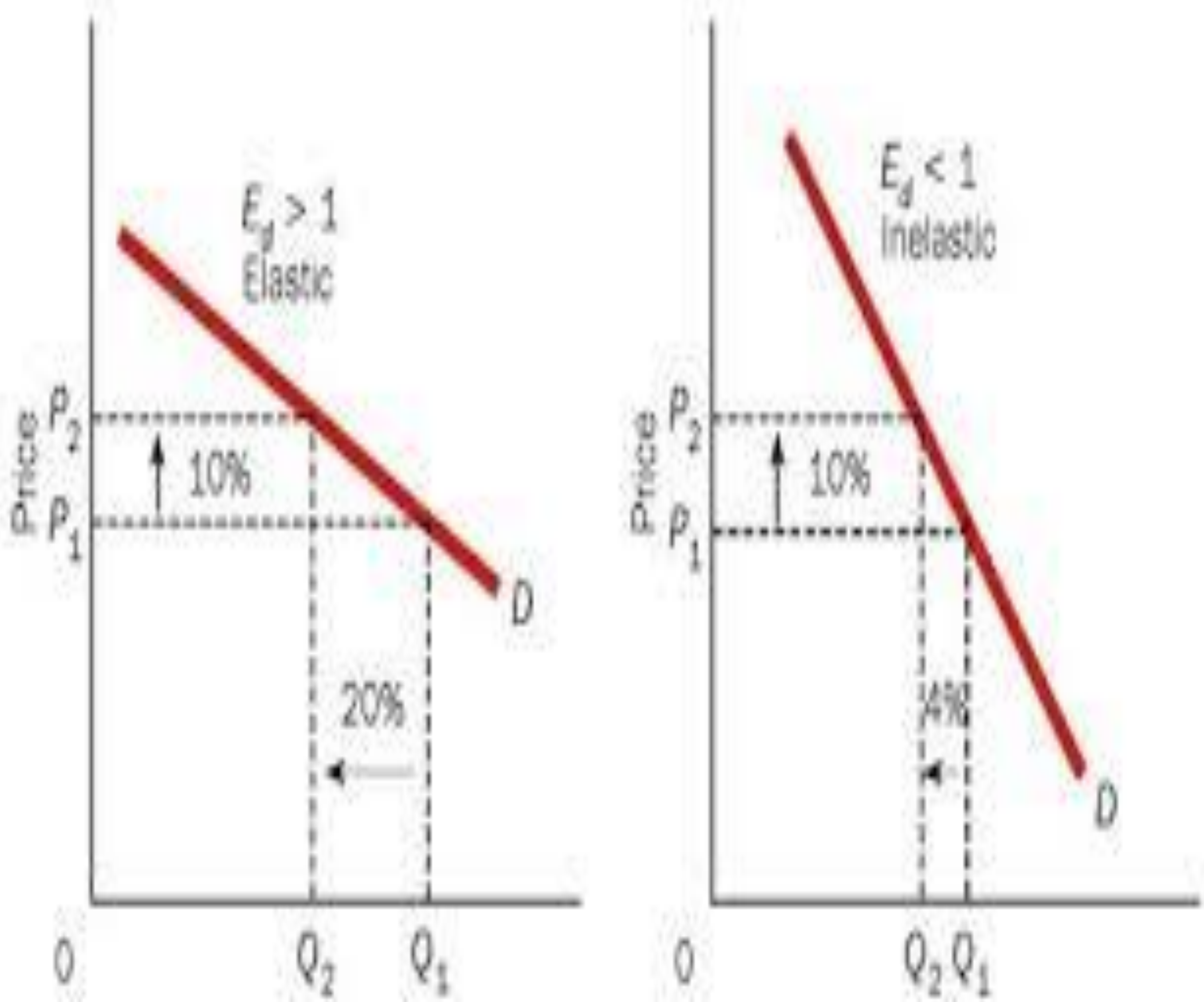
Definition of Elasticity of Demand

INTRODUCTION

Elasticity of demand is defined as the degree of responsiveness of demand to change in the price of a commodity. Elasticity of demand measures the extent to which the quantity of a commodity demanded by consumers changes as a result of a change in the price of the commodity. ***Demand elasticity*** as it is also called can also be defined to refer to how sensitive the demand for a good is to changes in other economic variables, such as the prices and consumer income. It is calculated by taking the percent change in quantity of a good demanded and dividing it by a percent change in another economic variable.

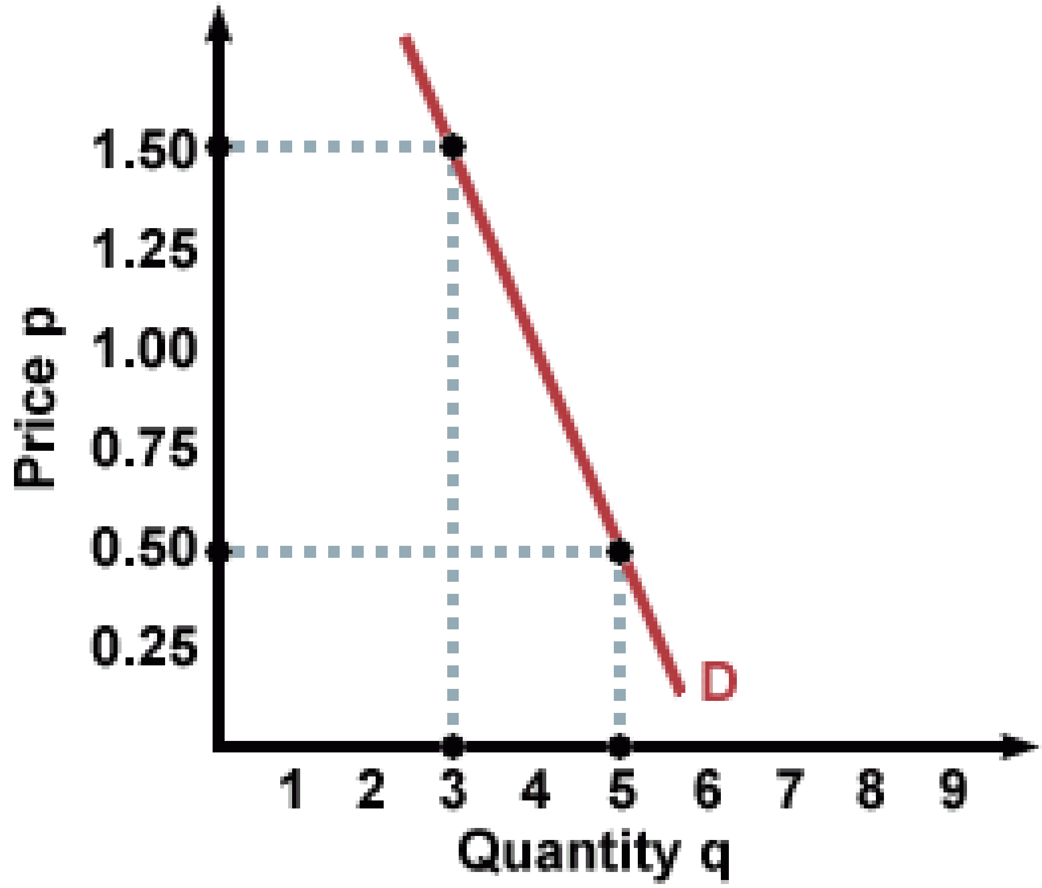
Types of price Elasticity of Demand

1. **Elastic Demand**: An elastic demand is the state of demand where a small change in price of goods and services leads to a greater change in the quantity of goods and services demanded. Elastic demand can also be described as fairly elastic demand. In this case elasticity is greater than one or unitary.



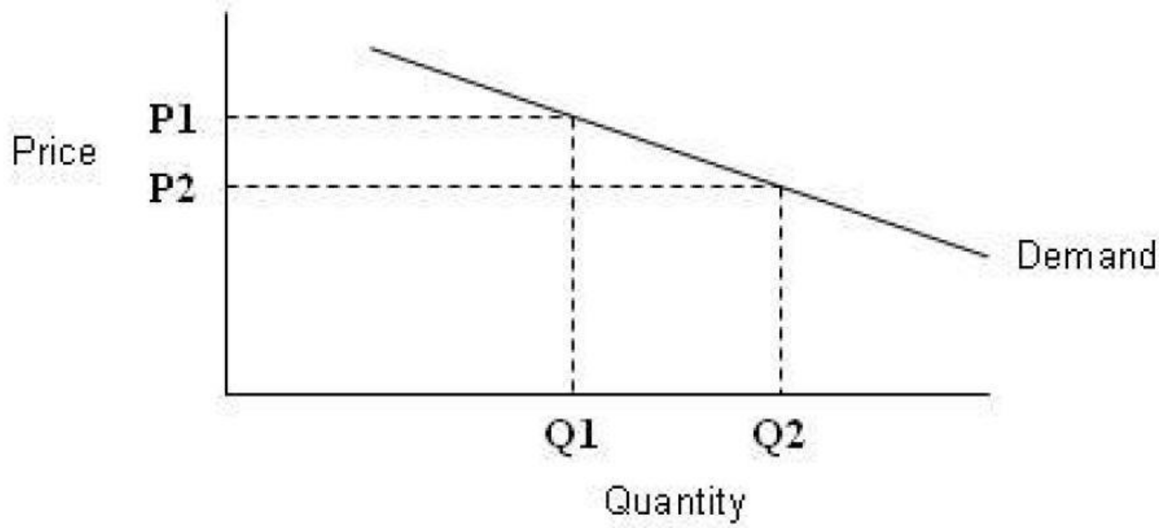
$E_d > 1$
Elastic
Price
P_2
P_1
10%
20%
D
0
Q_2
Q_1
$E_d < 1$
Inelastic
Price
P_2
P_1
10%
4%
D
0
Q_2 Q_1

2**. Inelastic Demand**: Demand is said to be inelastic if a larger change in price leads to a small or slight change in the quantity of goods demanded. In this case, elasticity is less than one but greater than zero, i.e E=>O<1. It can be described as fairly inelastic demand

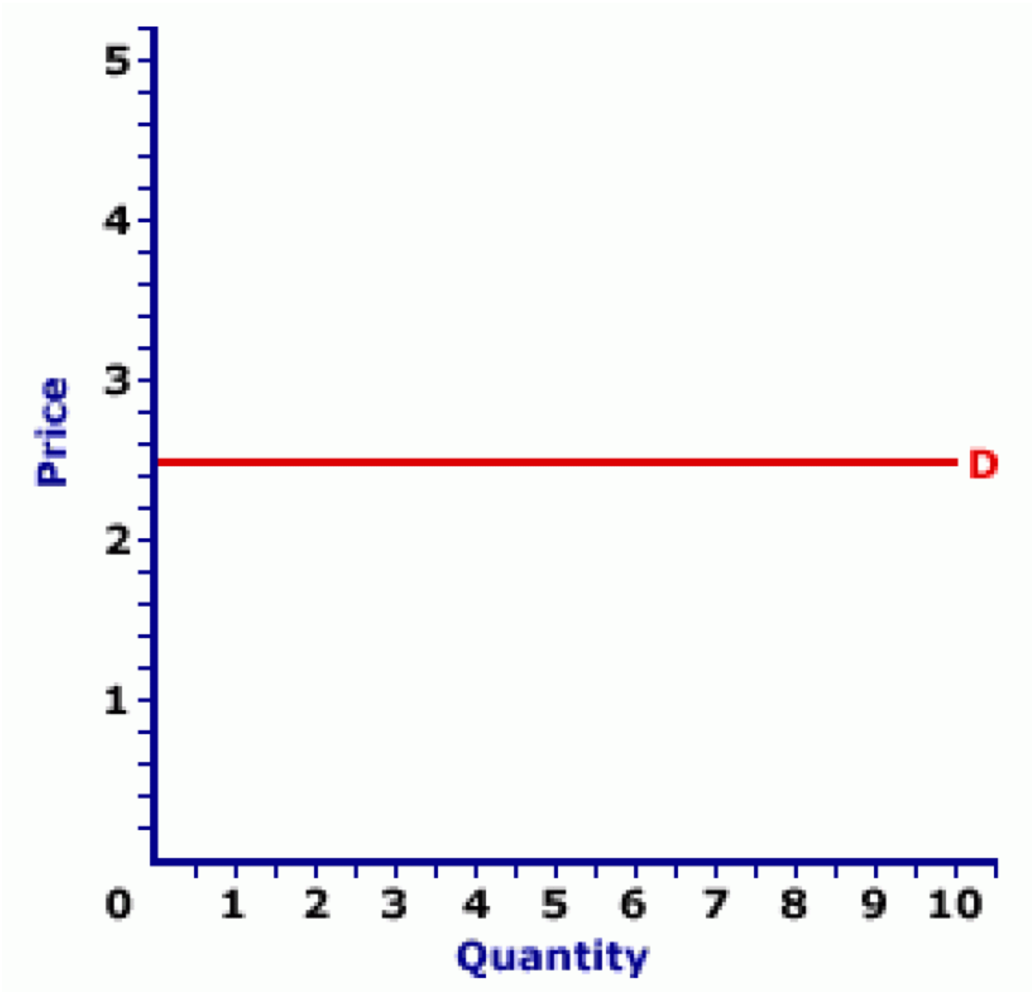


Inelastic Demand

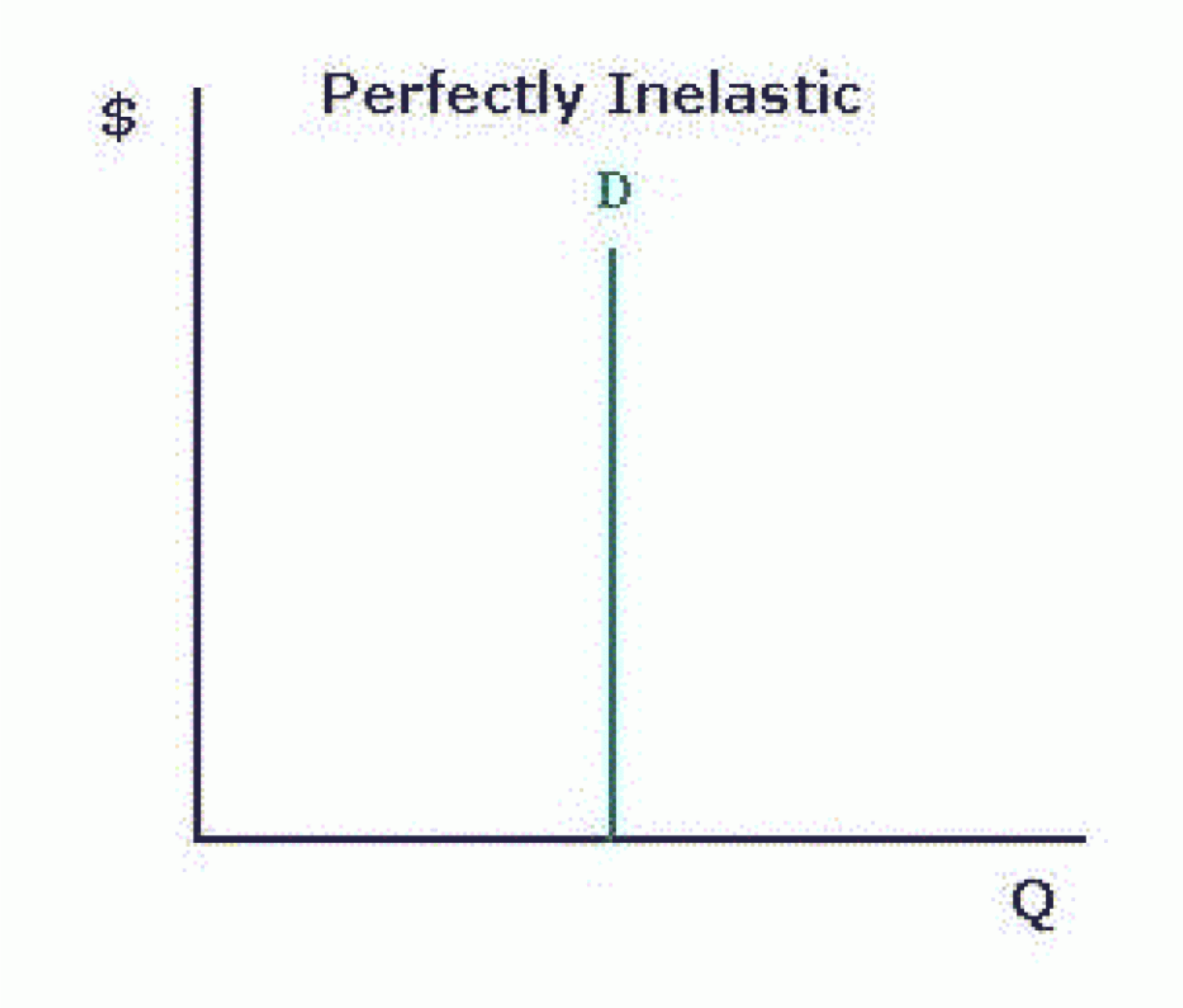
3. **Unity or Unitary elastic Demand**: Demand is said to be unitary elastic when a change in price leads to an equal change in the quantity of goods demanded, here a 5% change in price will bring about a 5% change in demand. In this situation E=1



4**. Perfectly Elastic Demand or infinitely elastic demand**: Demand is perfectly elastic when a change in price brings about an infinite effect on the quantity of goods demanded. I.e a slight increase in price can make consumer to stop purchasing the goods, here E=0



5. **Perfectly Inelastic Demand**: A demand is said to be perfectly inelastic if a change in price has no effect whatsoever on the quantity of goods demanded. This means that the same quantity of goods is demanded irrespective of the change in price.



Importance of Elasticity of Demand to Consumers, Producers and Government

1. **International trade:** In order to fix prices of the goods to be exported, it is important to have knowledge about the elasticity's of demand for such goods. A country may fix higher prices for the products with inelastic demand. However, if demand for such goods in the importing country is elastic, then the exporting country will have to fix lower prices.
2. **Formulation of Government Policies:** The concept of price elasticity of demand is important for formulating government policies, especially the taxation policy. Government can impose

higher taxes on goods with inelastic demand, whereas, low rates of taxes are imposed on commodities with elastic demand.

3. **Factor Pricing:** Price elasticity of demand helps in determining price to be paid to the factors of production. Share of each factor in the national product is determined in proportion to its demand in the productive activity. If demand for a particular factor is inelastic as compared to the other factors, then it will attract more rewards.
4. **Decisions of Monopolist:** A monopolist considers the nature of demand while fixing price of his product. If demand for the product is elastic, then he will fix low price. However, if demand is inelastic, then he is in a position to fix a high price.
5. **Paradox of poverty amidst plenty:** A bumper crop, instead of bringing prosperity to farmers, brings poverty. This is called the paradox of poverty amidst plenty. It happens due to inelastic demand for most of the agricultural products. When supply of crops increases as a result of rich harvest, their prices drastically fall due to inelastic demand. As a result, their total income goes down.

Test and Exercise

1. Define Elasticity of Demand
2. With the aid of diagram, explain various types of price elasticity of demand
3. Define price elasticity of demand

Week 11

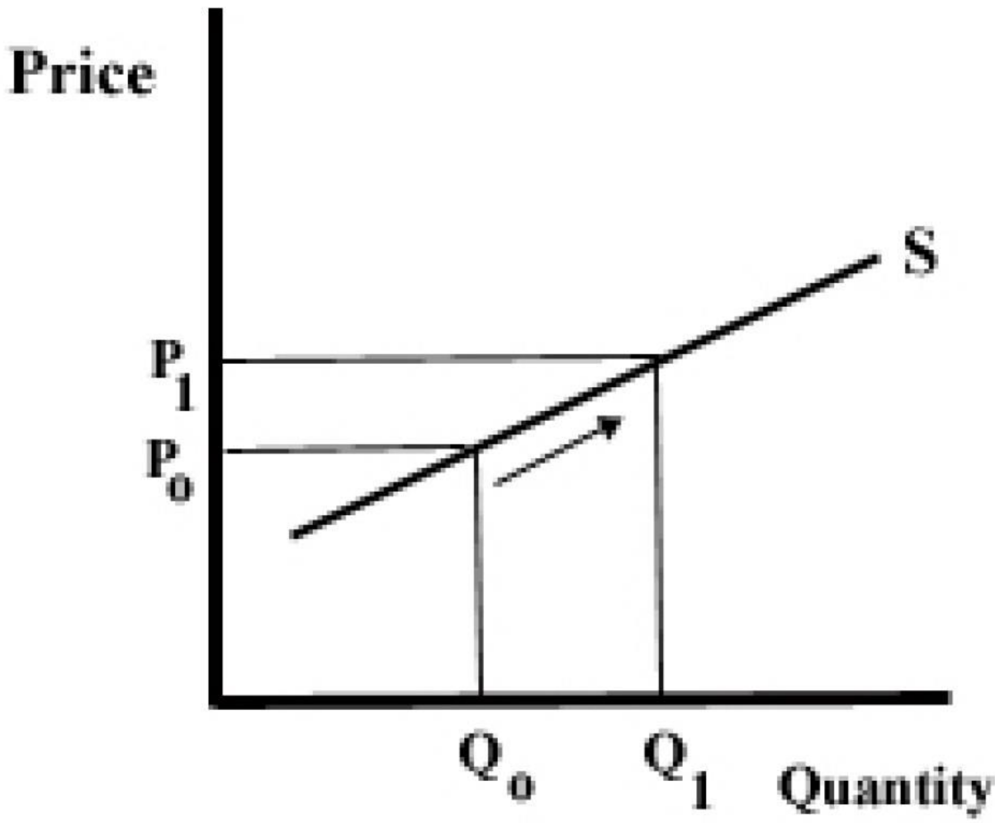
Elasticity of Supply

INTRODUCTION

Elasticity of supply can be defined as the degree of responsiveness of supply to little changes in the price of a commodity. It measures the extent to which the quantity of a commodity supplied by a producer changes as a result of little change in the price of the commodity.

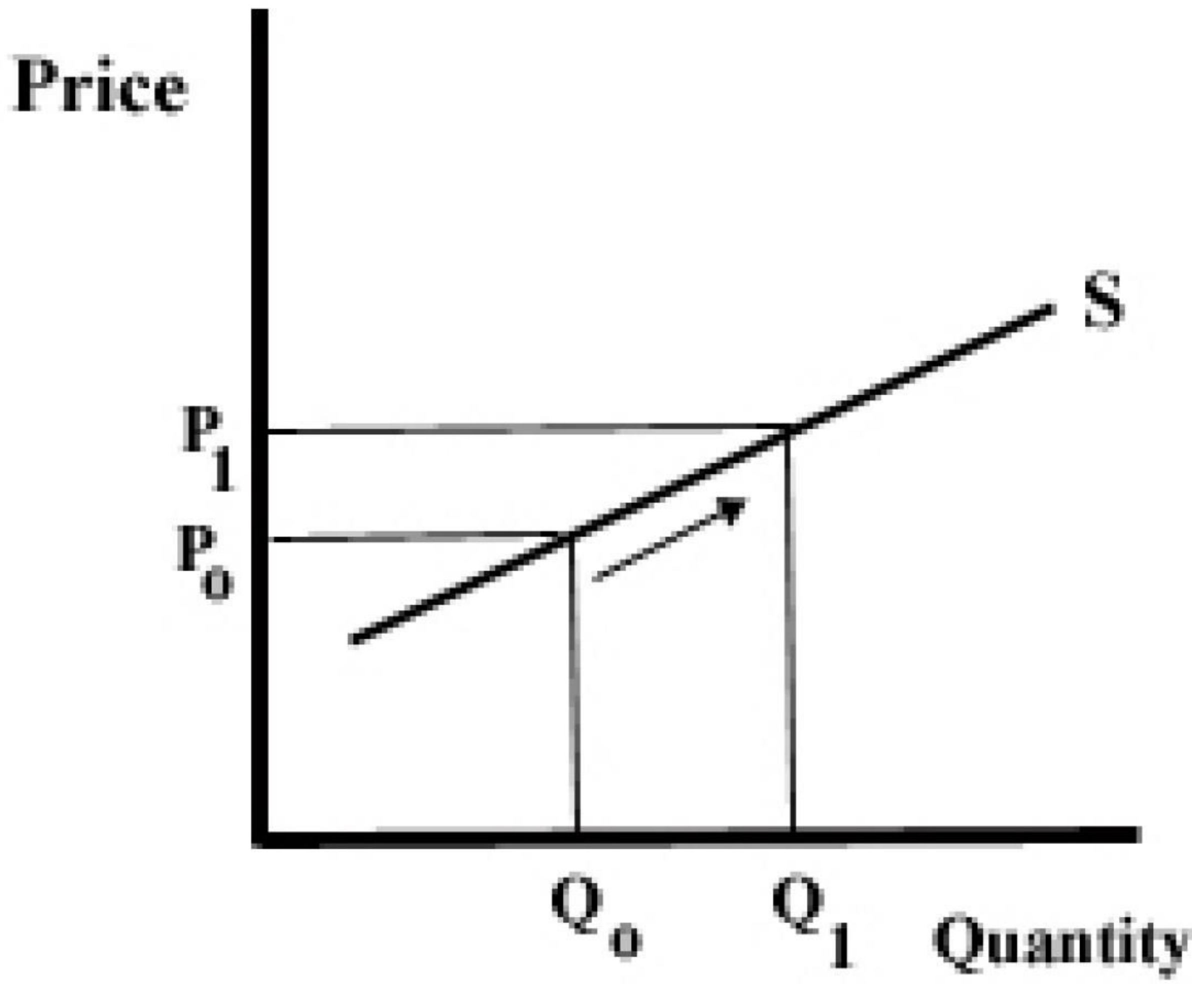
Types of Price Elasticity of Supply

1. Elastic supply: Supply is said to be elastic if a small change in price leads to a greater change in the quantity of goods supplied.



2. **Inelastic Supply or fairly inelastic supply:** Supply is said to be inelastic if a large change in price leads to a smaller or slight change in the quantity of goods supplied. Here, elasticity is less than one but greater than zero. If the value of the price elasticity of supply for a product is between zero and one, it is described as inelastic in supply and the supply curve will tend to be relatively steep.

3. Unity or Unitary Elastic supply: Supply is unitary when a change in price leads to an equal change in the quantity of goods supplied . I.e 10% change in price will bring about 10% change in supply.



4. Perfectly elastic supply or infinitely elastic supply: Supply is said to be perfectly elastic when a change in price brings about an infinite effect on the quantity of goods supplied, which means a slight change increase in price will bring about increase in supply of goods

5. Perfectly inelastic supply or zero elastic supply: Supply is perfectly inelastic if a change in price has no effect whatsoever on the quantity of goods supplied. Here elasticity is equal to zero. It is an economic situation in which the price of a product will have no effect on the *supply*.

Factors affecting Elasticity of supply

- **Cost of storag**e: Producers will supply all their commodities to the market if the cost of storage is very high, it makes the supply to be elastic.
- **Cost of production**: High cost of production normally results in elastic supply and vice versa
- **Nature of commodity**: Durable goods are inelastic due to their nature while perishable goods are elastic in supply

- **Market discrimination**: Elasticity of supply of a commodity depends on where it is sold. When few commodities are sold at a particular location as a result of lower price, such commodity can be taken to another location where the prices are higher.

Importance of Elasticity of Supply to Consumers, Producers and Government

1. Housing supply: Inelastic supply of new housing in response to rising demand can push up property prices with consequences for housing wealth, affordability etc.
2. Trade: The ability of a nation's export industries to respond to depreciation in the exchange rate if export demand grows – important for countries using the exchange rate as an instrument of macro policy.
3. Commodity prices: Inelastic supply of many hard and soft commodities – making prices more volatile –especially in markets where there is strong speculative activity – link to global food price inflation.
4. Labour market: Elasticity of supply of labour is a factor explaining wage differentials – i.e. migrant workers can help to relieve shortages of labour and improve the elasticity of supply.
5. Macroeconomics and the output gap: The changing elasticity of SRAS at different points of the economic cycle.
6. Elasticity of supply of renewable sources of energy as demand increases e.g. bio-fuels, solar power.
7. Quasi public goods: Public goods such as the airwaves, motorways, beaches etc which become crowded and congested –causing the marginal cost of supplying to an extra user to rise.
8. Government intervention in a market – if you are answering questions on maximum and minimum prices or indirect taxes and subsidies, you can always make a useful analytical point about the

importance of price elasticity of supply in affecting the results of any such market intervention.

Test and Exercise

1. Define Elasticity of supply
2. Explain types of price elasticity of supply
3. What are the factors affecting Elasticity of supply

Week 12

What is Income Elasticity of Demand?

INTRODUCTION

The **Income Elasticity of Demand** measures the relationship between a change in quantity demanded for good X and a change in real income. It can also be described as measuring the responsiveness of the quantity demanded for a good or service to a change in the income of the people demanding the good. It is calculated as the ratio of the percentage change in quantity demanded to the percentage change in income. In other words, the formula for calculating income elasticity is: ***% change in demand divided by the % change in income.***

For example, if in response to a 10% increase in income, the quantity demanded for a good increased by 20%, the income elasticity of demand would be 20%/10% = 2.

It is important to note that most products have a **positive income elasticity of demand**. So as consumers' income rises more is demanded at each price.

Mathematically, the Income Elasticity of Demand can be expressed thus-

Mathematically, it is expressed as:

$$\text{Income elasticity of demand} = \frac{\%\text{change in quantity demanded}}{\%\text{change in income}}$$

Symbolically, it is expressed as:

$$E_Y = \frac{\Delta q}{\Delta y} \times \frac{y}{q}$$

Where, E_Y = Elasticity of demand

q = Original quantity demanded

Δq = Change in quantity demanded

y = Original consumer's income

Δy= Change in consumer's income

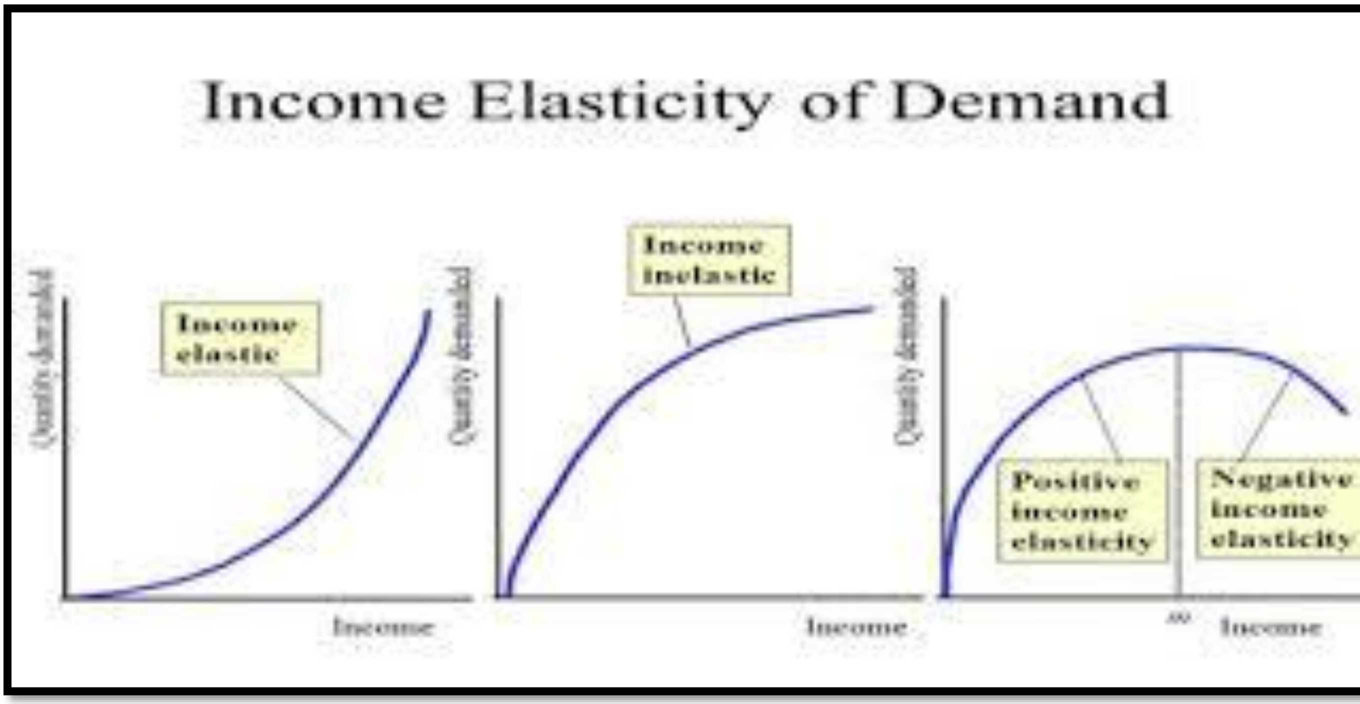
Types of Income Elasticity of Demand

1. Positive Income Elasticity of Demand (E_Y>O): If there is direct relationship between income of the consumer and demand for the commodity, then income elasticity will be positive. That is, if the quantity demanded for a commodity increases with the rise in income of the consumer and vice versa, it is said to be positive income elasticity of demand. For example: as the income of consumer increases, they consume more of superior (luxurious) goods. On the contrary, as the income of consumer decreases, they consume less of luxurious goods.

2. Negative income elasticity of demand (E_Y<O): If there is inverse relationship between income of the consumer and demand for the commodity, then income elasticity will be negative. That is, if the quantity demanded for a commodity decreases with the rise in income of the consumer and vice versa, it is said to be negative income elasticity of demand. For example:

As the income of consumer increases, they either stop or consume less of inferior goods.

In the given figure, quantity demanded and consumer's income is measured along X-axis and Y-axis respectively. When the consumer's income rises from **OY** to **OY_1** the quantity demanded of inferior goods falls from **OQ** to **OQ_1** and vice versa. Thus, the demand curve **DD** shows negative income elasticity of demand.



Income Elasticity of Demand
Quantity demanded
Income elastic
Income
Quantity demanded
Income inelastic
Income
Quantity demanded
Positive income elasticity
Negative income elasticity
Income

ASSESSMENT

1. What are the types of income elasticity of demand?
2. What is Income elasticity of demand?

What is Cross Elasticity of Demand?

The C**ross Elasticity of Demand** is an economic concept that measures the responsiveness in the quantity demand of one good when a change in price takes place in another good. In other words, it measures the responsiveness of the quantity demanded for a good to a change in the price of another good. This measurement is calculated by taking the percentage change in the quantity demanded of one good and dividing it by the percentage change in price of the other good.

Measurement of Cross Elasticity of Demand

As noted above, the Cross Elasticity of Demand is measured as the percentage change in quantity demanded for the first good that occurs in response to a percentage change in price of the second good. For example, if, in response to a 10% increase in the price of fuel, the demand for new cars that are fuel inefficient decreased by 20%, the cross elasticity of demand would be: .

ASSESSMENT

1. What is the Cross Elasticity of Demand?
2. How is the Cross elasticity of demand measured?

What is Price Control/Legislation?

Price Legislation or Price Control can be defined as referring to how the government or its relevant agencies fixes price of essential commodities such as fuel. It other words, it is a governmental restriction on the *prices* that can be charged for goods and services in a market. The need for price control is necessary, even though some have argued that it fails to protect the interests of some producers and consumers.

Types of Price Control

Minimum Price Control: These are typically the lowest prices according to legislation. Below this price limits, the product/service cannot be soled or bought by anybody. Mimimum prices are usually fixed on products with the aim of protecting producers (typically agricultural producers) from the negative effects fluctuations brought about by poor weather and the consequent poor harvest.

Maximum Price Control: This is the highest price level above which goods can neither be sold nor bought. In other words, people are prohibited (by law) to neither sell nor buy products above the legally set price limit.

Objectives of Price Control

1. To prevent the exploitation of consumers by unscrupulous producers.
2. To avoid/control inflation.
3. To help low-income earners
4. To control the profits of companies.
5. To stabilize the income of some companies
6. To make room for possible planning of future output.

The Effects of Price Control

1. It tends of stimulate excess demand which are usually not met.
2. It encourages hoarding of products by wholesalers and retailers. Example, during fuel scarcity, many filling stations refuse to sell their products even though they have it.
3. It gives rise to the phenomenon known as black market whereby underground sales of the product takes place; usually very expensive.
4. It encourages the conditional sale of products.

ASSESSMENT

1. Define Price Control
2. What are the types of price control?
3. List 5 objectives of price control?
4. What are some of the effects of price control?

Rationing and Hoarding: Definition

Rationing is the artificial restriction of raw materials, products services from being purchased by those in need of them. Rationing commonly occurs when governments fear a shortage and want to make sure people have access to necessities, such as after a natural disaster or during a war. Governments can also impose rationing in the face of failed policies such as central planning, or may be forced to use rationing as a result of shortages. It is related to ***hoarding*** which has to do with obtaining and holding scarce resources (be it raw materials or mainly goods and services) possibly so that they can be sold to customers for an overly increased prices. But unlike rationing which has an overall good intention, hoarding is usually the activity of business men who act in reaction to price controls by the government. The hoarding activities of these business men often give rise to the black market phenomenon which shall be discussed shortly.

Black Market and its Effects

The ***Black Market*** is the 'market' where goods and services are sold in a way that is illegal or for goods and services that are illegal. It is not "a market that is black" as in the physical sense of the word. Instead, what we mean by Black Market is that the collective transactions that take place between buyers and sellers are overly illegal.

There are some special goods and services that normally flow through the black market. Examples include guns, drugs, some antiques and artifacts, and even human trafficking. But, there are also black markets for things that are legal to own, but buyers and sellers just want to avoid either high taxes, set prices or any record of them buying something.

Just because the black market is full of illegal goods and transactions, doesn't mean it operates in isolation. Money goes in and out of the black market, so it does impact the real economy. One of the most significant ways is through employment. Some estimates place the worldwide employment in the black market at 15%-18%. Imagine if that many people, throughout the world, were unemployed. There would be some offsetting, as the volume of trade in the black market moved to the normal economy, but it would leave a lot of people not working.

Depending on the goods and services, the black market can also impact supply and demand for an individual firm. There are two good examples of this impact. First, the black market of guns. Because it is such a large black market, gun manufacturers don't use gun owners as a basis for measuring their target market. Instead, they identify their wholesale numbers (the number of guns they sold to stores), so that they are basing their forecasts and estimates on legal sales.

ASSESSMENT

1. Define Hoarding
2. Define Rationing
3. What is your understanding of ‘Black market’?
4. What are the effects of black market?

SECOND TERM NOTES
ECONOMICS

TABLE OF CONTENTS

Week 1

Definition of Money

Qualities or Characteristics of Money

Functions of Money

MONEY

Definition of Money

Money is anything that is generally acceptable as a medium of exchange and in the settlement of debts. Money is anything that is generally acceptable as a means of payment.

Qualities or Characteristics of Money

1. **General Acceptability**: Money must be generally acceptable by all in the society or country as a means of exchange. This shows the confidence people have in money.
2. **Portability**: The object that serves as money must be something that can easily be carried about from one place to another, which means such object has to be light in weight.
3. **Relative Scarcity**: Money must be relatively scarce, that is, it must not be too many so as not to lose its value.
4. **Homogeneity**: Each unit of money must be same in size, colour and quality and be the same nationwide.
5. **Durability**: The object that will serve as money must be able to last long, it must not be a perishable commodity, it must be able to stand the test of time.
6. **Stability**: The value of money must be stable. The stability of its value will help business to be predictable and encourage lending and borrowing of money.

7. **Divisibility**: Money must be capable of being divided into smaller units, e.g. ₦100, ₦50, ₦20 etc., to enable it to purchase both high and low priced commodities.
8. **Recognisability**: Money must be easily recognized and identified by the totality of the people in the society. It must not be easily counterfeited.
9. **No Intrinsic Value**: The commodity that should serve as money must have little or no value in itself as opposed to its value of exchange.

Functions of Money

Money performs the following functions:

1. **Medium of Exchange**: Money can serve as a medium through which money can exchange goods and services. Money can be used to buy different variety of goods and services. This facilitates the means of exchange. It came into use as a result of the inadequacies of the barter system. Money is therefore widely acceptable as payment for debts.
2. **Standard of Deferred Payment**: Since money can be stored, it can be accumulated to pay debts that are fixed in terms of money. Money can serve as a medium by which business transactions on credit can be settled in the future. The use of money makes it possible for payments to be deferred from the present to some future date.
3. **Unit of Account**: In serving as a unit of account, it becomes practically possible for individuals and companies to keep accounting record of their transactions in bank statements, ledgers and invoices.
4. **Store of Value**: Money is a good store of value because wealth can be stored for future use. When there is no inflation, money stored or saved retains its value for many years.

5. **As a Measure of Value**: The values of goods and services are expressed by prices, therefore money is used as a yardstick to measure and compare the worth of goods and services as well as occupation.

Test and Exercise:

1. The values of goods and services are expressed as _________

a)Money b) Prices c) Stores d) Debts.

2. ______ is not a characteristic of money

a) Elasticity b) Durability c) Divisibility d) Portability.

3. Homogeneity means money must be same in (i) size (ii) colour (iii) quality.

Which is correct a) I & II b) I, II & III c) II & III d) none of the above.

4. Money must be ________ scarce.

a) Very b) Relatedly c) Relatively d) Heavily.

5. _______ is generally acceptable as medium of exchange

a) Barter b) Value c) Money d) Exchange.

The Meaning of Cost of Production

Cost of production refers to the total cost incurred by a manufacturer in the cause of producing a good or providing a service. These expenses (costs of production) include but not limited to the following- the cost of labor, cost of raw materials, cost of consumable manufacturing supplies and general overhead. Taxes levied by the government or royalties owed by natural resources extracting companies are also part of the cost of production.

From the above, it is clear that the cost of production (which can also be referred to as referred to as the production cost) include all the expenditures relating to the production of goods/services. Therefore, before a cost can qualify to be classified under the ***cost of production*** category, it must be directly tied to the generation of revenue for the company. Please note also that manufacturers deal with the cost of product of both the materials required to create an item as well as the labor needed to turn the raw materials into finished products.

The Meaning of Cost to an Accountant and an Economics

In Accounting and Business as a whole, the word “cost” is viewed as the monetary value spent by a company in order to produce something. An Accountant is therefore interested in cost because it tells him or her the total amount of money that a company spends on the creation or production of goods or services. Taking note of the cost of production helps an Accountant or to among other things be able to figure out the cost of production per unit and as such set the appropriate sales price for the products. To determine the cost f production per unit, Accountants divide the cost of production by the number of units produced.

Different Types of Economic Costs

Fixed Costs (FC): These type of costs does not vary with changing output. Fixed costs might include the cost of building a factory, insurance and legal bills. Even if your output changes or you don’t produce anything, your fixed costs stays the same. In the above example, fixed costs are always N1,000.

Variable Costs (VC): These are costs which depend on the output produced. For example, if you produce more cars, you have to use more raw materials such as metal. This is a variable cost.

Semi-Variable Cost: An example of a semi-variable cost is labour. If you produce more cars, you need to employ more workers to engage in the entire production and marketing activities. This is therefore a variable cost. However, even if you didn't produce any cars, you may still need some workers to look after empty factory.

Total Costs (TC): – Fixed + Variable Costs

Marginal Costs: Marginal cost is the cost of producing an extra unit. If the total cost of 3 units is 1550, and the total cost of 4 units is 1900. The marginal cost of the 4th unit is 350.

Opportunity cost: Opportunity cost is the next best alternative foregone. If you invest N1 million in developing a cure for pancreatic cancer, the opportunity cost is that you can't use that money to invest in developing a cure for skin cancer.

Economic Cost: Economic cost includes both the actual direct costs (accounting costs) plus the opportunity cost. For example, if you take time off work to a training scheme. You may lose a weeks pay N350, plus also have to pay the direct cost of N200. Thus the total economic cost = N550.

Accounting Costs: this is the monetary outlay for producing a certain good. Accounting costs will include your variable and fixed costs you have to pay.

Avoidable Costs: Costs that can be avoided. If you stop producing cars, you don't have to pay for extra raw materials and electricity. Sometimes known as an escapable cost.

Long and Short Term Costs

Long Term Costs are accumulated when firms decide to change their production levels over time in response to expected ***economic profits or***

losses. This will therefore mean that there will not be fixed ***factors of production***. On the other hand, Short Term Costs are accumulated in real time throughout the production process.

Differences between Long and Sort Term Costs

The main difference between long run and short run costs is that there are no fixed factors in the long run; there are both fixed and variable factors in the short run . In the long run the general price level, contractual wages, and expectations adjust fully to the state of the economy. In the short run these variables do not always adjust due to the condensed time period. In order to be successful a firm must set realistic long run cost expectations. How the short run costs are handled determines whether the firm will meet its future production and financial goals.

ASSESSMENT

1. A cost that is easily traceable to a cost object is known as:
   (a) indirect cost
   (b) variable cost
   (c) direct cost
   (d) fixed cost
2. A cost that is not easily or conveniently traceable to a cost object is known as:
   (a) collective cost
   (b) indirect cost
   (c) additional cost
   (d) conversion cost
3. Which of the following terms is used to denote the response of a cost to the change in business activity?
   (a) Cost behavior
   (b) Cost trend

(c) Cost response
(d) Cost accumulation

4. A cost that changes in total dollar amount with the change in the level of activity is known as:
(a) fixed cost
(b) mixed cost
(c) conversion cost
(d) variable cost

5. A cost that does not change, in total, with the change in activity is called:
(a) mixed cost
(b) fixed cost
(c) prime cost
(d) unchanged cost

ANSWERS

1. c
2. b
3. b
4. d
5. b

Week 2

THE MEANING OF REVENUE TO AN ECONOMICS

INTRODUCTION

The term ***revenue*** refers the money obtained by a firm through the sale of goods at different prices and over a certain period of time. In other words, ***revenue*** is the total amount of money that a company actually receives for selling its products and services during a specific period of time (like a year). This total income include all the discounts and deductions for all merchandise merchandise. To put it in the purest economic terms, it is the "top line" or "gross income" figure from which costs are subtracted to determine net income.

TYPES OF REVENUE

There are three types of revenue you should know, and these include-

1. Total Revenue
2. Average Revenue
3. Marginal Revenue

Total Revenue: This is the total receipts from the sales of a given quantity of goods/services. It is exactly what its name suggests- the total income of a business. To calculate the total income, multiply the quantity of goods sold by the price of the goods. You can also calculate it as the selling price of a firm's product times the quantity sold (i.e. total revenue = price × quantity). You can also let Total Report be the total revenue function: {\displaystyle TR(Q)=P(Q)\times Q} such "*Q*" is the quantity of output sold and "*P*(*Q*)" is the inverse demand function.

Average Revenue: Average revenue is the revenue generated per **unit** of output sold. It plays a role in the determination of a firm's profit. Per **unit**

profit is average revenue minus average (total) cost. A firm generally seeks to produce the quantity of output that maximizes profit.

Marginal Revenue: Marginal Revenue is the additional **revenue** that will be generated by increasing product sales by one unit. It can also be described as the unit **revenue** the last item sold has generated for the firm. As a result, it will have to lower the price of all units sold to increase sales by 1 unit.

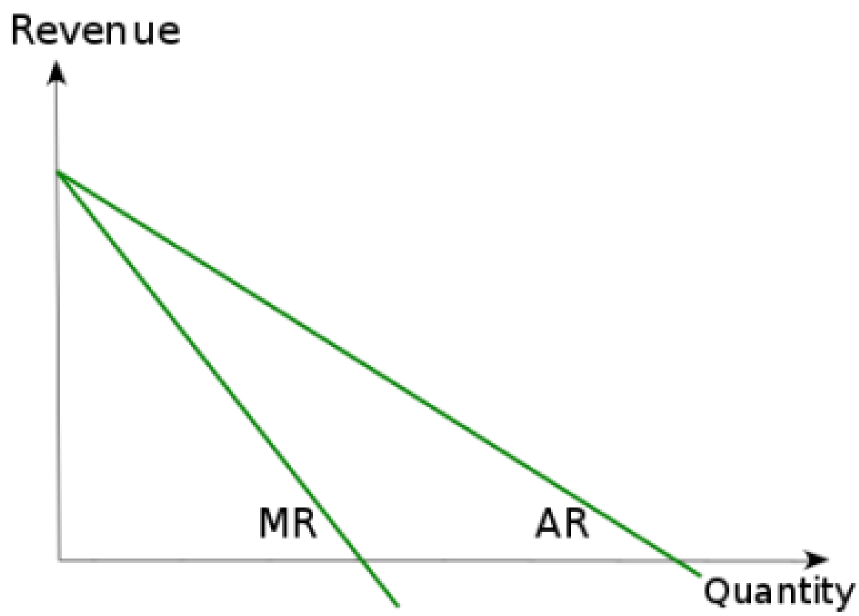
Marginal revenue is equal to the ratio of the change in revenue for some change in quantity sold to that change in quantity sold. This can also be represented as a derivative when the change in quantity sold becomes arbitrarily small. More formally, define the revenue function to be the following

{\display style R(q)=P(q)\cdot q} .

By the product rule, marginal revenue is then given by

{\displaystyle R'(q)=P(q)+P'(q)\cdot q} .

For a firm facing perfect competition, price does not change with quantity sold ({\displaystyle P'(q)=0}), so marginal revenue is equal to price. For a monopoly, the price decreases with quantity sold ({\displaystyle P'(q)<0}), so marginal revenue is less than price (for positive {\displaystyle q}).



Typical marginal revenue R’ and average revenue (price) <R> curves for a firm that is not in perfect competition.

ASSESSMENT

1. Revenue should be recognized or recorded when the goods are sold or services are rendered to the customer, this concept is known as:
   (a) Consistency concept
   (b) Realization Concept
   (c) Materiality concept
   (d) Matching concept
2. A record maintained which is measurable in the form of money, this concept of accounting is known as:
   (a) Matching concept
   (b) Consistency concept
   (c) Money measurement concept
   (b) Materiality concept
3. The cost of goods and services used up in the process of obtaining revenue is known as:
   (a) Revenue

(b) Expense
(c) Liability
(d) Expenditure

4. Which of the following is an accounting system in which events are recorded as and when they occur?
(a) Cash Accounting
(b) Accrual Accounting
(c) Both Accrual Accounting and Cash Accounting
(d) None of the above

5. If no distribution is made between capital and revenue expenditure then:
(a) The figure of debtors and creditors will be incorrect
(b) Cash or bank figure will be incorrect
(c) Net profit will be incorrect
(d) Balance sheet will not balance

ANSWERS

1. b
2. c
3. b
4. b
5. c

Week 3

The Definition of Economics Systems

INTRODUCTION

By Economic systems*,* we mean the various means through which different countries in the world have chosen to distribute resources within its citizens as well as trade their goods/services with members of the global community. Economic Systems are also used by countries to control the five factors of production namely- ***labor***, ***capital, land***, ***raw materials*** and ***entrepreneurship***. In other words, the different Economic Systems that abound have different (ad often times opposing) views as to how the factors of production should be utilized.

Types of Economic Systems and their characteristics

1. Capitalism
2. Socialism
3. Mixed Economy
4. Welfarism

Capitalism: This is an economic system that is based on the private ownership of all the ***means of production.*** Business operations in a capitalist economy are mainly for-profit. The central characteristics of a capitalist economic system include the following-

1. ***Private property***
2. ***Capital accumulation***
3. ***Wage labor***
4. ***Voluntary exchange***
5. ***A price system***

6. ***Competitive markets***

Note also that in a capitalist economic system, all business-related decision making and investments are determined by the owners of the factors of production; although the prices and the distribution of goods are mainly determined by market forces.

Socialism: Socialism is an economic system that is characterized by the social ownership and and often democratic control of all the means of production. Socialist economic systems can be divided into the following- ***non-market*** and ***market*** forms. Non-market social economic system involves the substitution of markets and money factors with engineering and technical criteria based on calculation performed in-kind. This thereby results in an economic mechanism that functions according to different economic laws from those of c**apitalism**. On the other hand, non-market socialism aims to circumvent the inefficiencies and problems often associated with capitalism. Below are some of the features of a socialist economic system-

1. ***Public ownership of the means of production***
2. ***Planned economy***
3. ***Classes of society***
4. ***The state is responsible for catering to all the needs of citizens***
5. ***Equal opportunities for everyone***
6. ***Absence of competition and limited product choices***
7. ***Pricing Mechanism***

Mixed Economy: A mixed economy is defined as an economic system consisting of a mixture of either markets and economic planning, public ownership and private ownership, or markets and economic interventionism. However, in most cases, “mixed economy” refers to market economies with strong regulatory oversight and governmental provision of public goods, although some mixed economies also feature a number of state-run enterprises. The features of a mixed economic system are briefly explained below-

Resource Ownership

In a command economy, all resources are owned and controlled by the state. In a mixed system, though, private individuals are allowed to own and control some (if not most) of the factors of production. Free market economies allow private individuals to own and trade, voluntarily, all economic resources.

State Intervention

Government intervention and political self-interest play a key role in a mixed economy. This intervention can take many forms, including subsidies, tariffs, prohibitions and redistributive policy.

Some of the most universally applied mixed economic policies include legal tender laws, monetary control by a central bank, public road and infrastructure projects, tariffs on foreign products in international trade and entitlement programs.

Changing Economic Policy

One important and understated feature of a mixed economy is its tendency for reactionary and purposeful economic policy changes. Unlike in a command economy (where economic policy is very often directly controlled by the state) or a market economy (market standards arise only out of spontaneous order), mixed economies can go through dramatic changes in the “rules of the game,” so to speak.

Factors to be considered when adopting an economic system

ASSESSMENT

1. What are the limitations of a free enterprise system?
   (a) High taxation and less incentive to work hard.
   (b) Uneven distribution of resources, consumer difficulty in obtaining information, and health-risk products.
   (c) Restrictions on personal freedoms.
   (d) There are no limitations.

2. There is little or no government control in a ___________ economy.
   (a) mixed
   (b) command
   (c) free market
   (d) traditional

3. Which of the answer choices is not a characteristic of a free market economy?
   (a) Public Property
   (b) Consumer Sovereignty
   (c) Profit
   (d) Private Property

4. Which of the following is NOT a type of economic system?
   (a) free market economy
   (b) command economy
   (c) traditional economy
   (d) public market economy

5. In the former Soviet Union consumers had to wait in long lines to buy everyday items like bread. They did not have many choices and the government controlled factories. What type of economy did they live in?
   (a) command economy
   (b) mixed economy
   (c) traditional economy
   (d) free market economy

ANSWERS

1. b
2. c
3. a
4. d
5. a

WEEK 4

What is Labour Market?

INTRODUCTION

Simply defined, the labour market refers to the supply and demand for labour such that employees provide the supply and employers provide the demand. It is a major component of all economies, and is intricately tied in with markets for capital, goods and services. At the ***macroeconomic*** level, supply and demand are influenced by both domestic and international market dynamics, as well as other important factors such as immigration, the age of the population and education levels. Relevant measures include unemployment, productivity, participation rates, total income and GDP. At the ***microeconomic*** level, individual firms interact with employees either to hire them or to fire them as well as raising or cutting wages and work hours. The relationship between supply and demand influences the hours the employee works and compensation she receives in wages, salary and benefits.

The Concept of Labour Force

The concept of labour force is generally used to describe people working for either a single company or an the entire workforce of a particular industrial sector, region or a country. Some companies like to describe their values as their workforce because when the workforce is strong and motivated, productivity will certainly be high.

Do note that whereas labour force within corporations typically define the number of personnel working there, the labour force of a country includes both the employed and the unemployed. The ***labour force participation rate*** **[LFPR]** otherwise known as the **economic activity rate**, **EAR,** is the ratio between the labour force and the overall size of their cohort (i.e., national population of the same age range). The term generally excludes the employers themselves, focusing on everyone who is capable and available to be hired to work.

Factors affecting the Size of Labour Force

1) Population: The size of a population determines (to a great extent) the number of people who will be available to engage in production activities. If the population is low, the number of people capable and available to work will be low. On the other hand, if the population is high, there will be more people available to work. Meanwhile, another factor to consider as it relates to population is whether the population is young or aged. A population comprised of mostly able-bodied youths will definitely have a better workforce than those comprised of aged, dependent people.

2) **Educational Qualification:** Education plays a key role in determining the size of any given labour force. This is because very many of the available professions in the world require high level of academic mastery in order that one may fit into their given fields and be productive.

3) **Government Policies:** The Government plays a huge role in determining the size of the labour force. If government policies are favourably-disposed to business enterprises, they will be compelled (by the labour of demand) to hire more people who will facilitate the production exercise. But if [unfortunately] the policies of Government are bad, businesses will not thrive and as such a lot of people will not be absorbed by the labour market. This will in turn make the labour force small.

4) Number of available Industries: The number of available industry also determine the size of the labour force. If the industries are few, fewer people would be hired. In a country like Nigeria where they are just a few industries, we have a small labour force because very many people are out of work due to the unavailability of work.

5) Wage/Salary Scales: The remuneration of labour often serve as a factor determining the size of the labour force. It goes like this- if the remuneration is favourable, more and more people will be attracted to work. But if this is not the case, it will ultimately discourage many from working.

Efficiency and Mobility of Labour

Mobility of labour means the capacity and ability of labour to move from one place to another or from one occupation to another or from one job to another or from one industry to another. There are two types of labour mobility- ***geographic*** and ***occupational***. A geographic labour mobility occur when labour move from one place to another in search of better-paying or better-satisfying jobs. Most people in Nigeria have family relatives who have emigrated out of the country in search of greener pastures abroad. Meanwhile, occupational labour mobility can also occur, such that people shift jobs; moving from one sector to another. There are a number of Nollywood actors who were once either doctors or bankers but along the line decided to become actors. That exemplifies occupational labour mobility.

Factors Determining Mobility of Labour

There are several factors that determine mobility of labour. Some of these factors include-

1. ***Education and Training***
2. ***Outlook or Urge***
3. ***Social Set-up***
4. ***Means of Transport***

ASSESSMENT

1. Individuals from which selection can be done after applying all recruitment strategies are classified as
   (a) labor force population
   (b) applicant population
   (c) applicant pool
   (d) labor market
2. In an organization, process of qualified individuals' pool generation for specific jobs is classified as

(a) staffing
(b) recruiting
(c) analyzing
(d) leading

3. Supply pool outside organization to attract individuals for job is classified as
(a) compression market
(b) affirmative market
(c) applicant market
(d) labor market

4. Total number of individuals who are selected for actual evaluation are classified as
(a) labor force population
(b) applicant population
(c) applicant pool
(d) labor market

5. Subset population of total labor force population is classified as
(a) applicant pool
(b) labor market
(c) labor force population
(d) applicant population

ANSWERS

1. a
2. b
3. d
4. c
5. d

Week 5

Explaining Supply and Demand for Labour

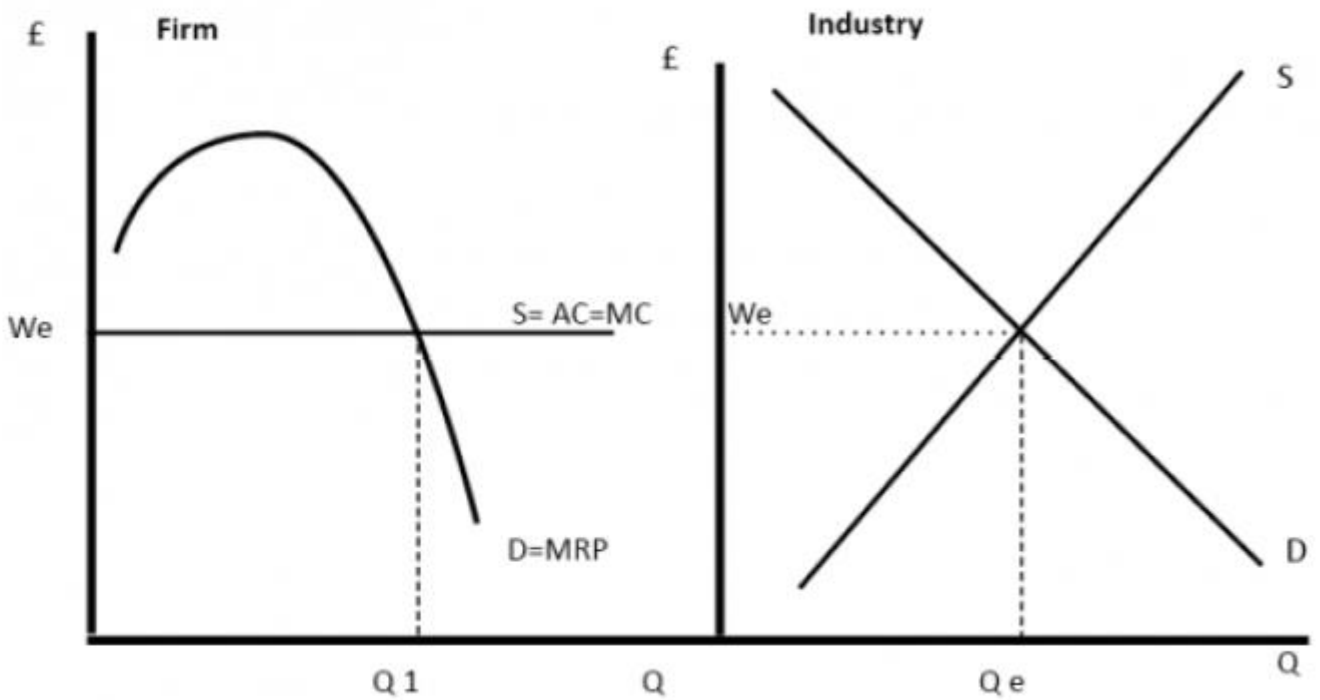
Demand for labour is a concept that describes the amount of labour that an economy or specifically a company is willing and ready to hire at a given point in time. Note that this demand may not necessarily be in long-term and is typically determined by the real wage companies are capable and willing to pay for the labour and the value such labour will bring to the company. Demand for labour increases market wages and enables more workers to enter the labour market. But the inevitable costs that come with hiring more labour may cause employers to use less labour.

Wage Determination

A wage determination is the listing of wage rates and fringe benefits which labourers are entitled. These rates are set by employers, and in most cases apply across board (specifically within sectors) such that labour forces working in certain fields are sure to receive a certain level of remuneration; irrespective of the different companies they work for. Meanwhile, competition also helps to set wage determination. A perfectly competitive labour market will have the following features

- Many firms
- Perfect information about wages and job conditions
- Firms are offering identical jobs
- Many workers with same skills

Diagram of Wage Determination



- The equilibrium wage rate in the industry is set by the meeting point of the industry supply and industry demand curves.
- In a competitive market firms are wage takers because if they set lower wages, workers would not accept the wage.
- Therefore they have to set the equilibrium wage We.
- Because firms are wages takers the supply curve of labour is perfectly elastic therefore AC = MC
- The firm will maximise profits by employing at Q1 where MRP of Labour = MC of Labour

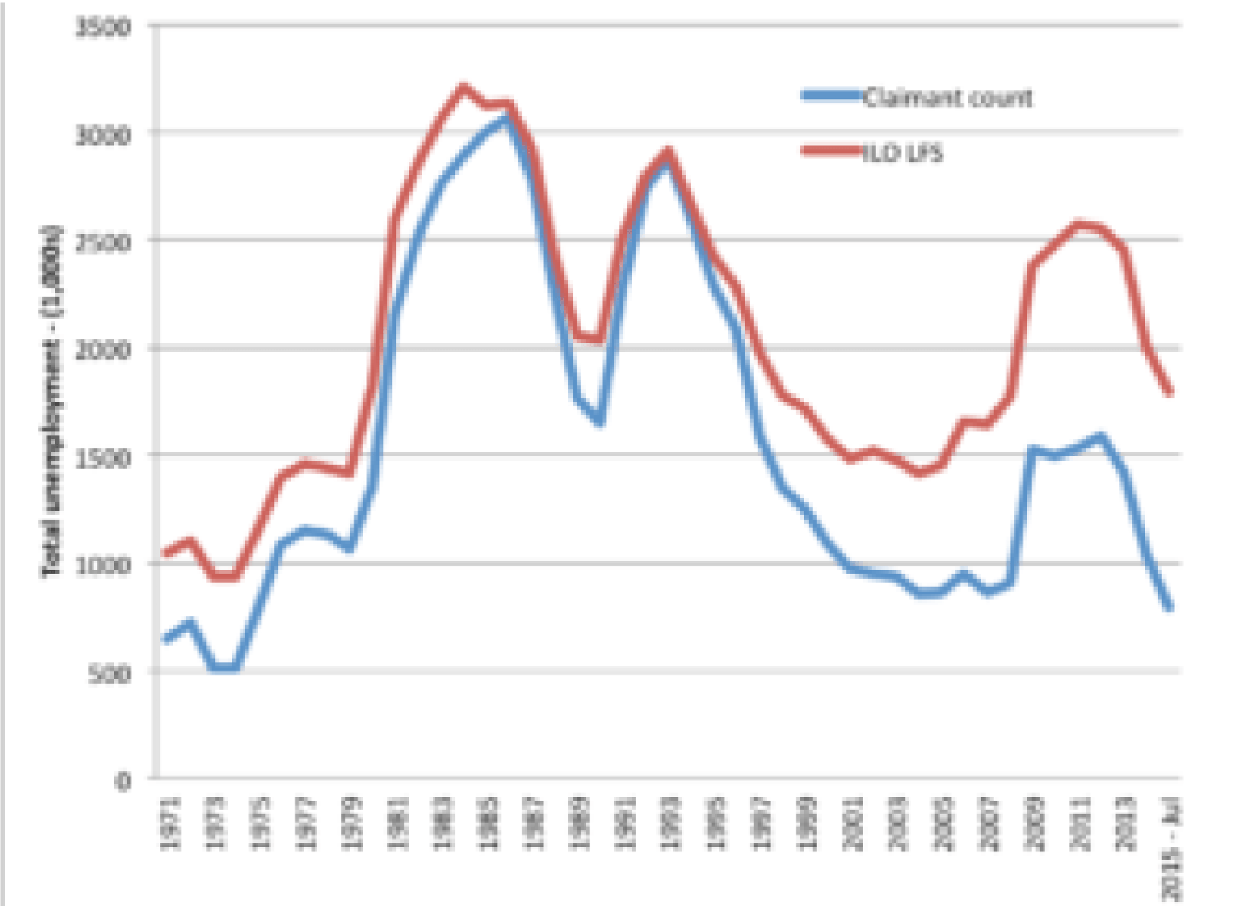
Meaning and Types of Unemployment

Unemployment is defined as a situation where someone within the working age bracket, healthy and able-bodied is not able to work; either out of choice or because they are unable to be in full time employment. It is important to note however that mothers who leave work to raise children and people taking time to acquire higher education are not necessarily classified as unemployment. This is because in the meantime they are raising kids and acquiring education, they are not concurrently seeking employment because of course they are busy. One grey area however is ***voluntary unemployment***. This occurs when the unemployed choose not to take a job a the going wage rate (e.g. wrong job, benefits too high e.t.c) They could be counted as unemployed because they are still seeking a job (they just don’t want to take one they are offered.

Types of Unemployment

- Cyclical Unemployment.
- Frictional Unemployment.
- Structural Unemployment.

A Graph Measuring Unemployment



ASSESSMENT

1. ____ is a concept that describes the amount of labour that an economy or specifically a company is willing and ready to hire at a given point in time
   (a) demand for labour
   (b) wage determination
   (c) cyclical unemployment
   (d) frictional demand

2. Demand for labour may lead to the following except
   (a) increases in market wages
   (b) enables more workers to enter the labour market
   (c) increases in costs that come with hiring more labour
   (d) reduction of a company's value

3. The listing of wage rates and fringe benefits which labourers are entitled is known as
   (a) demand for labour
   (b) supply of labour
   (c) wage determination
   (d) equilibrium wage rate
4. A perfectly competitive labour market will have the following features except
   (a) many firms
   (b) perfect information about wages and job conditions
   (c) firms are offering identical jobs
   (d) many workers with different skills set
5. The situation where someone within the working age bracket, healthy and able-bodied is not able to work is
   (a) supply
   (b) labour
   (c) wage
   (d) unemployment

ANSWERS

1. a
2. d
3. c
4. d
5. d

Week 6

What is Market Structure?

INTRODUCTION

Market structure can be defined as the organisational framework of a market. It can also entail of the basic characteristics that make a particular market distinct and unique from the others. In this vein therefore, the focus is on those characteristics that affect the nature of the competition and pricing within a certain market. By the way, the meaning is the organised system of trading peculiar to people in certain industries. Some of the features of a market structure are highlighted below-

- ***Customer turnover rate***
- ***The extent of product differentiation***
- ***The nature of costs***
- ***The number of firms within the market (level of competition)***
- ***The market shares of each of the firms; specifically the largest firm among the bunch***
- ***The structure of buyers in the market***
- ***The degree by which the market is vertically integrated***

Types of Market Structure

Perfect Market Structure: A Perfect Market Structure, otherwise known as perfect competition, is a type of market structure where competition is rife and many producers can freely produce similar products while trying to sell same to customers. There are low barriers to entry and the ***demand curve*** is very elastic.

Features of a Perfect Competition

1. Many firms
2. Freedom of entry
3. Homogeneous product
4. Normal profit.
5. Cheap and efficient communication and transportation
6. High consumers turnover rate
7. Market shares of the largest firm is usually high

Market Equilibrium Position

A firm is said to be in equilibrium when it is most likely not going to change its level of output. At this point, it neither needs expansion nor contraction; therefore it remains the way it is. It just wants to earn maximum profits by equating its marginal cost with its marginal revenue, i.e. MC = MR.

Diagrammatically, the conditions of equilibrium of the firm are:

(1) The MC curve must equal the MR curve. This is the first order and necessary condition. But this is not a sufficient condition which may be fulfilled yet the firm may not be in equilibrium.

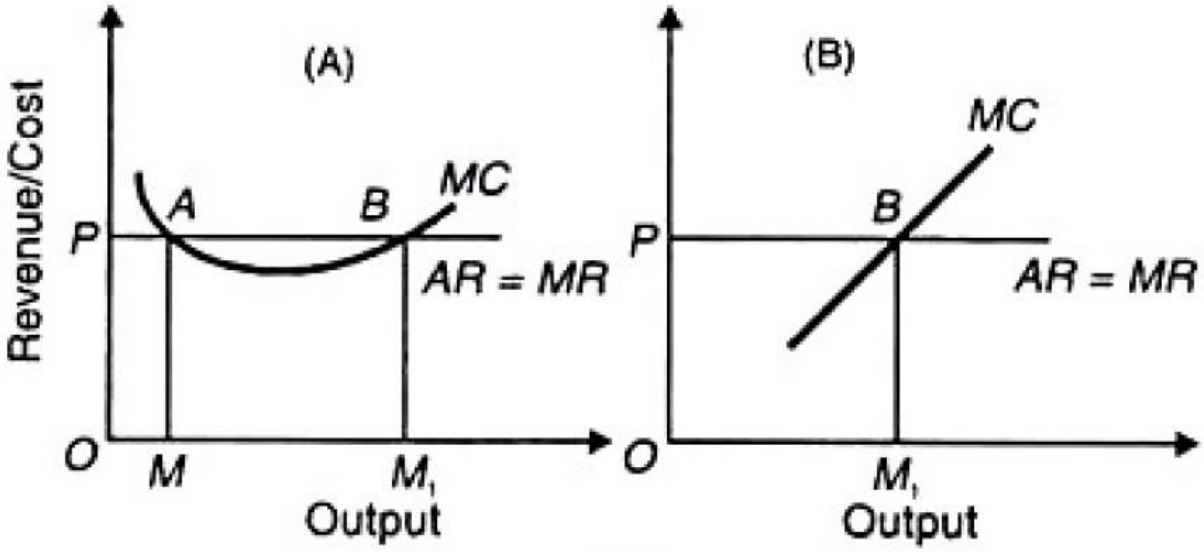


Fig. 1

(2) The MC curve must cut the MR curve from below and after the point of equilibrium it must be above the MR. This is the second order condition.' Under conditions of perfect competition, the MR curve of a firm coincides with the AR curve. The MR curve is horizontal to the X-axis. Therefore, the firm is in equilibrium when MC=MR=AR (Price).

ASSESSMENT

1. Which of the following is not a type of market structure?
   a. Competitive monopoly
   b. Oligopoly
   c. Perfect competition
   d. All of the above are types of market structures.

2. If the market demand curve for a commodity has a negative slope then the market structure must be
   a. perfect competition.
   b. monopoly.
   c. imperfect competition.

d. The market structure cannot be determined from the information given.

3. If a firm sells its output on a market that is characterized by many sellers and buyers, a homogeneous product, unlimited long-run resource mobility, and perfect knowledge, then the firm is a
   a. a monopolist.
   b. an oligopolist.
   c. a perfect competitor.
   d. a monopolistic competitor.

4. If a firm sells its output on a market that is characterized by a single seller and many buyers of a homogeneous product for which there are no close substitutes and barriers to long-run resource mobility, then the firm is
   a. a monopolist.
   b. an oligopolist.
   c. a perfect competitor.
   d. a monopolistic competitor.

5. If a firm sells its output on a market that is characterized by many sellers and buyers, a differentiated product, and unlimited long-run resource mobility, then the firm is
   a. a monopolist.
   b. an oligopolist.
   c. a perfect competitor.
   d. a monopolistic competitor.

ANSWERS

1. a
2. d
3. c

4. a
5. d

Week 7

What is Imperfect Competition?

INTRODUCTION

An imperfect competition is one in which the market structure shows some but not all the features of competitive or perfect market. It is a form of market situation whereby some of the important rules of a perfect market are not followed. It the direct opposite of a perfect market. In other words, an imperfect market refers to any market situation that does not meet the so called rigorous standards of a hypothetical perfectly competitive market. An imperfect market arises whenever individual buyers and sellers can influence prices and production, or otherwise when perfect information is not known to all market actors.

In the real world, most markets follow this model of competition. This is because practically, imperfection is inevitable. It is important to note that in imperfect competition, the price of goods can increase above their ***marginal cost*** and thus have consumers decrease their level of purchase.

Imperfect competition can also be defined as a situation where there are many sellers who are selling ***heterogeneous*** goods as opposed to the perfect competitive market scenario. Imperfect competition is the real world competition. Today some of the industries and sellers follow it to earn surplus profits. In this market scenario, the seller enjoys the luxury of influencing the price in order to earn more profits. If a seller is selling a non identical good in the market, then he can raise the prices and earn profits. High profits attract other sellers to enter the market and sellers, who are incurring losses, can very easily exit the market.

Types of Imperfect Market

- **Oligopoly:** A situation in which there are few sellers of a product.

- **Monopolistic competition:** A situation in which there are many sellers producing highly differentiated products.
- **Monopoly:** Where there are many buyers but only one seller.
- **Monopsony:** Where there are many sellers but one buyer.
- **Oligopsony: W**here there are many sellers but few buyers.

Market Structure	Seller Entry Barriers	Seller Number	Buyer Entry Barriers	Buyer Number
Perfect Competition	No	Many	No	Many
Monopolistic competition	No	Many	No	Many
Monopoly	Yes	One	No	Many
Duopoly	Yes	Two	No	Many
Oligopoly	Yes	Few	No	Many
Monopsony	No	Many	Yes	One
Oligopsony	No	Many	Yes	Few

Price Discrimination

Price discrimination is a microeconomic pricing strategy where identical or largely similar goods or services are transacted at different prices by the same provider in different markets. Price differentiation is distinguished from product differentiation by the more substantial difference in production cost for the differently priced products involved in the latter strategy. Price differentiation essentially relies on the variation in the customers' willingness to pay and in the elasticity of their demand.

ASSESSMENT

1. In a perfectly competitive market, a company demand curve is
   (a) perfectly elastic
   (b) perfectly inelastic
   (c) imperfect market
   (d) elastic
2. Buyers competent of making realistic purchases based on information given are
   (a) rational buyers

(b) rational sellers
(c) buyers
(d) sellers

3. In perfect competition, every profit-exploiting manufacturer looks a market price identical to it's
   (a) marginal revenue
   (b) marginal cost
   (c) Profit maximization
   (d) perfectly elastic

4. A absolutely competitive industry has a
   (a) perfectly elastic supply curve
   (b) perfectly elastic demand curve
   (c) negatively sloped demand curve
   (d) positively sloped demand curve

5. Point where market demands will be same to market supply
   (a) equilibrium in perfect competition
   (b) equilibrium in imperfect competition
   (c) equilibrium competition
   (c) all of answers are correct

ANSWERS

1. a

2. a

3. b

4. c

5. a

Week 8

What is Imperfect Competition?

INTRODUCTION

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   (b) equilibrium in imperfect competition
   (c) equilibrium competition
   (c) all of answers are correct

ANSWERS

1. a
2. a
3. b
4. c
5. a

Week 9

What does "Location of Industry" Mean?

INTRODUCTION

This simply has to do with
the geographical spread of economic activity in an economy. Every economy in every country in the world have its own economic hub, even though some countries (such as the very developed countries) are fortunate enough to have their own ***locations of industries*** spread across. Note that there are several factors responsible for the location of industries. Locating an industry is a major business decision made by business executives. And they often make these decisions bearing the aforementioned ***factors*** in mind. Some of these factors include but not limited to the
following- proximity to raw material supplies, availability of labour,good co mmunications and nearness to markets. One of the good things about locating an industry is that once Once it is established in
a particular area, it serves as a focal point for more economic expansion by attracting the establishment of ancillary trades.

Factors affecting the Location of Industries

The factors affecting the location of industries are majorly divided into two namely-

1) Geographic

1. Availability of raw materials
2. Availability of electricity
3. Availability of qualified labour force
4. Good transportation network
5. Availability of water
6. Close proximity to the targeted market

7. Availability of good, affordable and ***flat*** site for locating the factory
8. A conducive climatic condition

2) Non-geographic factors.

1. Availability of the needed startup capital
2. Favourable/unfavourable government policies
3. Close proximity to banking facilities
4. Availability of insurance companies

What are the advantages and disadvantages of localization of Industries?

Advantages

1. It brings about economic development within the specific location
2. A large market for a certain type of labour is developed
3. Labour force gets trained and equipped
4. Financial facilities grow even as more banks and other financial services providers establish businesses within the area.
5. Basic amenities get developed even as overall development gets to the new area of industrialization
6. There is a stimulus for starting subsidiary companies to provide support to the main companies.
7. The reputation of a locality for particular kinds of goods widens.

Disadvantages

1. There is an over-dependence on the main industry which may not be healthy
2. Over-population may become a problem.

ASSESSMENT

1. The geographical spread of economic activity in an economy is known as
   (a) economic portal
   (b) economic hub
   (c) economic spread
   (d) economic area
2. This is not a factor responsible for the location of industries
   (a) proximity to raw material supplies
   (b) availability of labour
   (c) nearness to markets
   (d) race of customers
3. The non-geographic factors affecting the location of industries are all these except
   (a) availability of the needed startup capital
   (b) favourable/unfavourable government policies
   (c) close proximity to banking facilities
   (d) availability of water
4. One of these is not an advantage of localisation of industries
   (a) it brings about economic development within the specific location
   (b) a large market for a certain type of labour is developed
   (c) labour force gets trained and equipped
   (d) Over-population may become a problem
5. One of these is not true about setting up an industry in a particular location
   (a) it serves as a focal point for more economic expansion
   (b) it attracts the establishment of ancillary trades
   (c) it leads to the reduction of economic development of that locality
   (d) it increases the reputation of that locality for particular kinds of goods widens.

ANSWERS

1. b
2. d
3. d
4. d
5. c

THIRD TERM NOTES ON ECONOMICS

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THIRD TERM

TOPIC: MONEY

What is Money?

Money is defined as ***anything*** that is generally acceptable as a medium of exchange and in the settlement of debts. It is a means of payment, and can also be defined as any verifiable item or record that is generally accepted by people as a means for payment for goods/services. Money can either be a legal tender within a given territory (as in the case of the naira) or it may have global recognition as it is the case with strong currencies such as the dollar, Pound and Franc.

Quality of Money

1. **General Acceptability:** Money must be generally acceptable by all in the society or country as a means of exchange. This shows the confidence people have in money.
2. **Portability:** The object that serves as money must be something that can easily be carried about from one place to another, which means such object has to be light in weight.
3. **Relative Scarcity:** Money must be relatively scarce, that is, it must not be too many so as not to lose its value
4. **Homogeneity:** Each unit of money must be same in size, colour and quality and be the same nationwide
5. **Durability:** The object that will serve as money must be able to last long, it must not be a perishable commodity, it must be able to stand the test of time.
6. **Stability:** The value of money must be stable. The stability of its value will help business to be predictable and encourage lending and borrowing of money.
7. **Divisibility:** Money must be capable of being divided into smaller units, e.g. ₦100, ₦50, ₦20 etc., to enable it to purchase both high and low priced commodities.

8. **Recognisability:** Money must be easily recognized and identified by the totality of the people in the society. It must not be easily counterfeited.
9. **No Intrinsic Value:** The commodity that should serve as money must have little or no value in itself as opposed to its value of exchange.

Functions of Money

1. **Medium of Exchange:** Money can serve as a medium through which money can exchange goods and services. Money can be used to buy different variety of goods and services. This facilitates the means of exchange. It came into use as a result of the inadequacies of the barter system. Money is therefore widely acceptable as payment for debts.

2. Standard of Deferred Payment: Since money can be stored, it can be accumulated to pay debts that are fixed in terms of money. Money can serve as a medium by which business transactions on credit can be settled in the future. The use of money makes it possible for payments to be deferred from the present to some future date.

3. **Unit of Account:** In serving as a unit of account, it becomes practically possible for individuals and companies to keep accounting record of their transactions in bank statements, ledgers and invoices.

4. **Store of Value:** Money is a good store of value because wealth can be stored for future use. When there is no inflation, money stored or saved retains its value for many years.

5. **As a Measure of Value:** The values of goods and services are expressed by prices, therefore money is used as a yardstick to measure and compare the worth of goods and services as well as

What are the Motives for holding Money?

For Transaction Purposes: For most most business establishments and even individuals, considerable amounts cash balances are required to meet daily transactions. Business establishments inevitably have to hold cash for meeting payment requirements that arise in the cause of daily business activities.

Precautionary Purposes: Business concerns hold money to meet uncertainties and emergencies. The holding of cash on these reasons are very inevitable. The unavailability of cash to meet uncertainties may result in prolongation or disruption of operating cycle.

Speculative Motive: Sometimes, firm hold high cash balances over the precautionary level of cash balance to take advantage of speculative investment opportunities, to exploit discounts for prompt payments, to improve credit rating etc. Cash surplus companies can acquire the cash starved companies at least cost of acquisition. The company with excessive cash surplus can take steps to improve production and sales ultimately the profitability of the company improves.

Future Requirements: The cash balances are held to meet future payment obligations like payment of tax, payment of dividend, purchase of fixed asset, redemption of debentures, repayment of term loan, buy-back of shares etc.

Compensating Balances: A firm generally has to hold cash balances to compensate its banker for the services provided.

The Elementary Quantity Theory of Money

"The quantity theory of money states that there is a direct relationship between the quantity of money in an economy and the level of prices of goods and services sold. According to the theory, if the amount of money in an economy doubles, price levels also double, causing inflation (the percentage rate at which the level of prices is rising in an economy). The consumer therefore pays twice as much for the same amount of the good or service."

ASSESSMENT

1. Define Money
2. List the qualities of money
3. What are the functions of money?
4. What are the motives for holding money?
5. State the Elementary quantity theory of money.

TOPIC: FINANCIAL INSTITUTIONS

The Definition of Financial Institutions

Financial institutions are establishments that render financial services or conduct financial transactions such as ***investments***, ***loans*** and ***deposits*** for clients. Most people deal with financial services providers (i.e., financial institutions) almost on a daily basis on a regular basis. This is because every financial activities such as depositing money and getting loans as well as exchanging currencies are done through financial institutions.

There are two major types of financial institutions we shall be looking at in the cause of this lesson. These are- the ***Money Market*** and the ***Capital Market***.

The Money Market

The money market has to do with the trading of every financial instruments with high liquidity and very short term maturities rates. It is said to be used by participants as a means to borrow and lend on a short term basis, with maturity periods that usually range from one day to half a year.

Functions of the Money Market

To finance trade: Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market.

To finance industry: The money market contributes to the growth of industries by helping to securing short-term loans for industry stakeholders so they can meet their working capital requirements through the system of ***finance bills***, ***commercial papers etc.***

Profitable Investment: Money market enables the commercial banks to use their excess reserves in profitable investment.

Instruments used in the Money Market

- ***Treasury Bills***
- ***Federal Agency Notes***

- ***Short-Term Tax Exempts***
- ***Certificates of Deposit***
- ***Commercial Paper***
- ***Bankers' Acceptances***
- ***Repurchase Agreements***

The Capital Market

The Capital market is defined as the type of financial institution which provides money for periods longer than a year. Capital markets typically channel savers' monies to those who can put it to long-term productive use. These type of borrowers are usually companies or governments who desire to make long-term investments.

Functions of the Capital Market

1. The capital market helps businesses raise long-term funds for investment

2. The capital market provides opportunity for the public to invest their savings in attractive securities which provide a higher return.

3. A well developed capital market can easily attract foreign investment.

4. The activities of the capital market ultimately engenders economic growth.

5. Anyone can easily study the economic conditions of a country using the Capital market as a barometer of the economy.

6. *Capital market provides opportunities for different institutions such as commercial banks, mutual funds, investment trust; etc., to earn a good return on the investing funds. They employ financial experts who are able to predict the changes in the market and accordingly undertake suitable portfolio investments.*

Instruments used in the Capital Market

1. ***Debt Instruments***
2. ***Equities (also called Common Stock)***

3. ***Preference Shares***
4. ***Derivatives***

ASSESSMENT

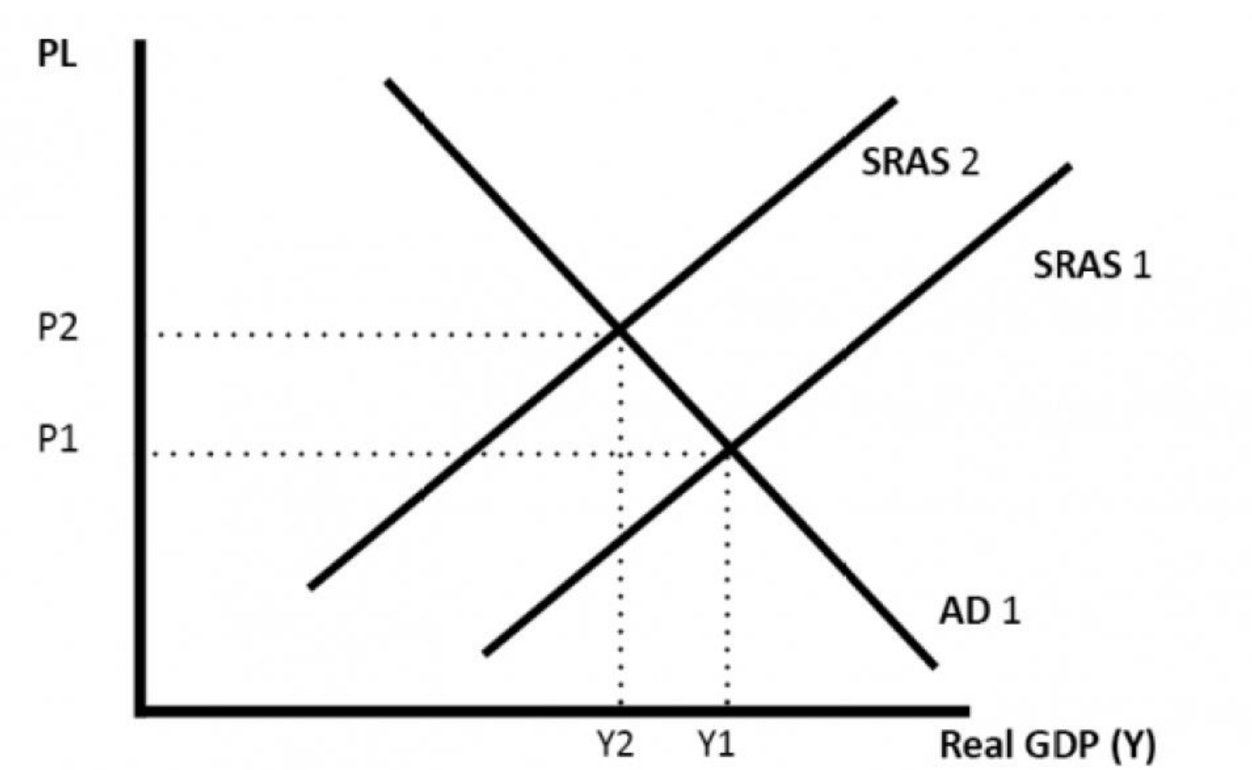
1. Define Financial Institutions
2. What are the two major types of financial institutions?
3. What is the money market?
4. What are the functions of money market?
5. What are the instrument’s used in money market?
6. What is capital market and what are the functions of capital market?

TOPIC: INFLATION

What is Inflation?

Inflation is an economic situation whereby there is a continuous rise in the over all prices of all types of products and services. It therefore causes serious economic hardship and is typically pronounced when people cannot easily afford the basic necessities of life. Economists measure inflation as an annual percentage increase such that when there is inflation in 2017 as against the year before, every naira you have in 2017 can only purchase less than what it was capable of purchasing the year before. In other words, the value of the naira automatically depreciates during inflation. And by "depreciate", we mean that its ***purchasing power*** drops; often drastically. Take for instance, assuming the current inflation rate in Nigeria is three percent, then every bottle of Coca Cola (which previously sold for N100) will then sell for N130. So to simply put it, inflation makes it impossible for your naira to buy what it used to buy.

Types of Inflation



Simple diagram showing cost push inflation.

Cost-push inflation: This occurs when there is an increase in the cost of production for firms causing aggregate supply to shift to the left. Cost push inflation could be caused by rising energy and commodity prices.

Wage Inflation: This is a type of inflation that is created by the sudden rise of workers' salaries/wages. It is usually associated with a recorded shortage of workers, which prompts the labour force and their unions to negotiate for higher wages. And when workers' wages rise above what it normally should be, the company may feel the need their money back by hiking the price of their product.

Core Inflation: Economists use the ***Core Inflation Rate*** to measures the rising prices of every other good/service except ***food items*** and ***energy***. This is because food prices (for instance) may fluctuate with the seasons, and there will not be need to adjust interest rates every time this happens.

Hyperinflation: Hyperinflation is when the prices of goods and services skyrocket more than 50% a month! It is said to be very rare occurrence although it is safe to assume that Zimbabwean economy is currently in a state of hyperinflation.

Other types of Inflation include-

1. ***Deflation***
2. ***Galloping Inflation***
3. ***Walking Inflation***
4. ***Creeping Inflation***
5. ***Stagflation***
6. ***Asset Inflation etc***

Causes of Inflation

1) Rising House Prices: Although this does not directly cause inflation, it has been known to cause a positive wealth effect and encourage what is called ***a consumer-led economic growth*** which can indirectly cause inflation.

2) Printing more Money: If the Central Bank of Nigeria (for any reason) decides to prints more money, such a decision would inevitably cause an unprecedented rise in inflation. This is because money supply plays an important role in determining prices. If there is more money chasing the same amount of goods, then prices will rise. Hyperinflation is usually caused by an extreme increase in the money supply.

Effects of Inflation

1. There will be problem with the redistribution of income and wealth as the rich may get richer while the poor continue to be poor.
2. Creditors will lose money while debtors gain, especially so if the creditor failed to anticipate inflation.
3. People who live off a fixed-income (retirees for instance) may witness sharp declines in their purchasing power and, consequently, their standard of living.
4. Persons who hold shares or stocks of companies gain during inflation.
5. There may be a drastic reduction in the number of products produced by companies
6. Products qualities may also reduce
7. There may be hoarding of products and even capital in the black market
8. Inflation encourages speculation which may often not be good for business

ASSESSMENT

1. Define inflation.
2. List the effects of inflation
3. What are the causes of inflation?
4. List some of the types of inflation

TOPIC: PUBLIC FINANCE

What is Public Finance?

For Economists, Public Finance can be defined as the study of the direct role of Government in the economy. It is preoccupied with assessing and analysing government revenue and the expenditure of the public authorities towards the achievement of desirable effects. Public Finance can also be defined from the perspective of analysing the sources of government revenue; the collection of taxes and how said money collected for taxes are used for the provision of public goods by the governments.

To reiterate the fact, Public Finance deals with government ***expenditure*** and ***revenue***. It examines everything from taxation to public borrowing and lending, allocation of funds from the federal to the state and local governments and all the agencies of government. Also, it examines how the public money generated and spent directly impact people's lives.

Objectives of Public Finance

1. **Provision of employment:** Public finance is used to create employment in the country for those who are unemployed.
2. **Revenue generation:** Through the public finance, the government of a country is able to generate revenue for the country and used the generated revenue to meet the needs of the society.

3. **Satisfaction of needs:** Through public finance, the government is able to identify the needs of the people thereby creating means of satisfying or meeting the needs of the people to satisfy them.
4. **Price stabilization:** through the public finance, the government is able to stabilize the prices of goods and services so as to avoid inflation or deflation of goods and services in the community.
5. **Equitable distribution of income:** Public finance ensures that the revenue generated is distributed equally to the different economic sector of the economy and ensures there is no partiality in the distribution of the national resources.

Fiscal Policy

Fiscal policy is the use of government revenue collection (mainly taxes) and expenditure to influence the economy. According to ***Keynesian Economics***, when the government changes the levels of taxation and government spending, it influences aggregate demand and the level of economic activity. Fiscal policy can be used to stabilize the economy over the course of the business cycle

Objectives of Fiscal policy

1. **Full employment:** It is very important objective of fiscal policy. Unemployment reduces the level of production, and hence the level of economic growth. It also creates many problems to the unemployed people in their day-to-day life. So, countries try to remove unemployment and attain full employment. Full employment refers to that situation, where there is no involuntary unemployment in the economy. To attain this objective, government tends to:

-
    - Increase its spending
    - Lower the personal income taxes
    - Lower the business taxes, or
    - Employ a combination of increasing government spending and decreasing taxes

However, in practice, it is difficult to achieve full employment. As the factor markets are not perfect, factor units may lose their jobs and may not get the new jobs immediately

2. **Economic growth**: It is also an important objective of fiscal policy. By means of higher rate of economic growth, the problem of unemployment can also be solved. However, it may create some problems in the maintenance of price stability.
3. **Resource allocation:** Resource allocation refers to assigning the available resources of the economy to the specific uses chosen among many possible and competing alternatives. It gives answer to what to produce and how to produce-questions of the economy. Fiscal policy should ensure the optimum allocation of the resources. It should divert the resources from unproductive sectors to the productive sectors of the economy.
4. **Increase in Savings:** This policy is also used to increase the rate of savings in the country. In the developing countries rich class spends a lot of money on luxuries. The government can impose taxes on them and can provide the basic necessities of life to the poor class on low rate. In this way by providing incentives, savings can be increased.
5. **Equal Distribution of Wealth:** Fiscal policy is very useful for the achievement of equal distribution of wealth. When the wealth is equally distributed among the various classes then their purchasing power increases which ensures the high level of employment and production.
6. **Control Inflation:** Fiscal policy is very useful weapon for controlling the rate of inflation. When the expenditure on non productive projects is reduced or the rates of taxes are increased then the purchasing power of the people reduces.
7. **Reduce the Regional Disparity:** In the less-developing countries, the regional disparity is found. Some areas are more developed while the others are less developed. Government provides the infrastructure facilities in less developed areas. The tax holiday

incentive is also provided in these areas which are very useful in increasing the per capita income.

8. **Check Rapid Increase in Consumption:** Fiscal policy is also used to check the rapid increase in the consumption will be high then the rate of saving will be low and consequently rate of investment will be low. So one country cannot improve her economic condition without increasing the investment.

Meaning of taxation

Taxation can be defined as the chief means through which Public Finance is raised to finance government expenditures. It typically involves by imposing charges or citizens and corporate entities which they must pay as long as they remain citizens of a country or operate businesses within the territory of a country. In this vein therefore, taxation can also be defined as the process or method of imposing a compulsory levy by the government or its agency on individuals and firms or on goods and services. The Governments can also use taxation to either encourage or discourage certain economic decisions made by both private individuals and business corporations. For example, reduction in taxable personal (or household) income by the amount paid as interest on home mortgage loans result in greater construction activity, and generates more.

Reasons for Taxation

1. **To redistribute income**: the government uses tax to redistribute tax through the Pay As You Earn (P.A.Y.E) method, this method help the government to narrow the gap between the rich and the poor by introducing progressive taxation.
2. **It is used to correct the adverse balance of payment:** Taxes are used to correct the adverse balance of payment. Importation of foreign goods can be reduced through the use of heavy tax import duties.
3. **To protect infant industries**: Government can help to protect new industries from competition with the foreign companies

4. **Promotion of Economic growth**: Taxes can be used to promote economic growth. Government can reduce taxes on company profits so that these profits are diverted back into the business for expansion.
5. **Employment purpose:** Government can also manipulate taxation to achieve desired employment level. Also the money paid by the tax payers can be used to create more jobs for the unemployed.
6. **Direction of production and investment**: Taxation can be used to direct production and investment.
7. **To control inflation**: Taxes can be used as anti-inflationary devices; this can be possible if the government increases direct tax without increasing her expenditure.

Types of Taxation (Direct and Indirect Taxation)

Direct Taxation: This is the type of tax that taxpayers pay directly to the government. These taxes cannot be shifted to others. Workers pay the tax which is often deducted directly from their salaries even before they see it.

Indirect Taxation: An indirect tax can be passed on to another person or group. A business may recover the cost of the taxes it pays by charging higher prices to customers. In other words, a tax shift or indirect taxation occurs when the business shifts its taxes to others.

ASSESSMENT

1. Define Public Finance
2. What is Fiscal Policy
3. Define Taxation
4. What are the reasons for taxation?
5. What are the objectives of Fiscal policy?
6. What are the objectives of public finance?

TOPIC: SOURCES OF GOVERNMENT REVENUE

What is 'Incidence of Taxation'?

This is an economic term for describing how the tax burden between buyers and sellers is divided. It is said to be directly related to the price elasticity of demand and supply such that when supply is more elastic than demand, the buyers bear the tax burden. On the flip side, if demand is more elastic than supply, producers bear the tax burden. The incident of taxation therefore represents the distribution of the tax obligations that must be covered whenever there is a buying and selling. It is important to bear in mind that the level at which each party participates in covering the tax obligation shifts based on the associated price elasticity of the product/service in question as well as how the product/service is currently affected by the principles of ***demand and supply***. In any case, never forget that the whole essence of taxation is to raise money for public expenditure. Taxation is (as a matter of fact) the main source of Public Finance as we already saw in the previous lesson. Let is now see how government spend money generated from taxation.

The Structures of Public Expenditure (Re-current and Capital Expenditure)

Public expenditure has to do with all the expenses incurred by the government in its purchase of value for public utility. It can also be seen as the spending made by the government of a country on the collective needs/wants of its citizenry; such needs as payment of pension, provision of infrastructure, etc. In all public expenditure plays four major roles as you shall see enumerated below-

1. it contributes to current effective demand
2. it expresses a coordinated impulse on the economy, which can be used for stabilization, business cycle inversion, and growth purposes;
3. it increases the public endowment of goods for everybody;
4. it gives rise to positive externalities to economy and society as a whole (or in specific sectors and geographical areas), the more so through its capital component

Re-current Expenditure versus Capital Expenditure

Re-current expenditure has to do with payments made by governments or organizations for every other purpose except for ***capital costs***. These include payments for goods and services as well as interest and subsidies. Recurrent expenditures are typically made more than once, and may even be made on a scheduled basis. Some expenses, such as ***wages and salaries*** made to employees by companies, are made periodically on a monthly basis. However, re-current expenditure excludes payments for capital assets such as ***stock, bonds and property***. The latter are examples of ***capital expenditure***. It is important to bear in mind that both capital and recurrent expenditures both make up the overall expenditure, and account for all fees and net lending that is doled out by governments.

ASSESSMENT

1. What is incidence of taxation?
2. What are the four major roles of public expenditure?
3. Compare Recurrent expenditure to Capital expenditure.

TOPIC: <u>BUDGET</u>

What is a Budget?

A budget could be defined as the quantitative expression of any financial plan specified for a certain period. It could entail everything from planned sales volumes, resource quantities, costs and expenses, assets, liabilities to expected cashflows/profits. It basically expresses the strategic financial plans of businesses, organizations over defined time-frames. A budget can also be defined as the sum of money allocated for a particular purpose and the summary of intended expenditures along with proposals for how to meet them. It is the estimated revenue and expenses over a specified [future] period of time, usually compiled and re-evaluated on a periodic basis.

Types of and Importance of Budget

1. ***Master Budget***
2. ***Operating Budget***
3. ***Cash Flow Budget***
4. ***Financial Budget***
5. ***Static Budget***

Master Budget: This is an aggregation of a company's individual budgets which is designed to present the complete picture of such a company's financial activity and health. This type of budget combines factors such as sales, operating expenses, assets, and income flows with the intention of allowing the company to set goals and evaluate [their] overall performance.

Operating Budget: The operating budget is like a forecast or an analysis of projected income and expenses over the course of a specified time period. In order to create an accurate analysis, operating budgets must account for such factors as sales, production, labor costs, materials costs, overhead, manufacturing costs, and administrative expenses. Businesses create this type of budget on either a weekly, monthly or yearly basis as it best suits them. And its use is to analyse whether the company is spending too much on supplies.

Cash Flow Budget: A cash flow budget is a means of projecting how and when cash comes in and flows out of a business within a specified time period. It can be useful in helping a company determine whether it's managing its cash wisely. Cash flow budgets consider factors such as accounts payable and accounts receivable to assess whether a company has ample cash on hand to continue operating, the extent to which it is using its cash productively, and its likelihood of generating cash in the near future.

Financial Budget: A financial budget presents a company's strategy for managing its assets, cash flow, income, and expenses. A financial budget is used to establish a picture of a company's financial health and present a comprehensive overview of its spending relative to revenues from core operations. A software company, for instance, might use its financial budget to determine its value in the context of a public stock offering or merger.

Static Budget: A static budget is a fixed budget that remains unaltered regardless of changes in factors such as sales volume or revenue. A plumbing supply company, for example, might have a static budget in place each year for warehousing and storage, regardless of how much inventory it moves in and out due to increased or decreased sales.

National Debt: Meaning and Types

National debt is the total of all outstanding debt the government of a country owes either another country or international organizations or even businesses. It also includes not just the exact amount of money the government has borrowed, but all the accumulated interest that must pay on the borrowed money. A government is said to have gone into debt when it does not get enough revenue (from taxes and other means) to cover the expenses it incurs from spending its budget. Nigeria currently owes a lot of accumulated national debt.

There are different types of national debt which are enumerated below-

- ***Internal and External Debt***

- ***Productive and Unproductive Debt***
- ***Compulsory and Voluntary Debt***
- ***Short-term, Medium-term and Long-term loans***
- ***Funded and Unfunded Debt***
- ***Redeemable and Irredeemable Debt***

Financing Deficit Budget

A deficit budget is an economic situation which indicates that expenditures far exceed revenue. The term is often used commonly when talking about government spending rather than the expenditure of private business or individual. However, it can apply overboard nonetheless. In cases in which a budget deficit is identified, current expenses exceed the amount of income being received through standard operations. In order to correct a budget deficit, a nation may need to cut back on certain expenditures or increase revenue-generating activities, or employ a combination of the two.

ASSESSMENT

1. Define Budget
2. List the types of budget and their functions.
3. What is a deficit budget?
4. Define National debt.
5. What are the types of National debt?

TOPIC: Capital Market

What is a Capital Market?

A capital market is any financial market in which long-term debts and equity-backed ***securities*** are traded (i.e., bought and sold). These securities are typically Capital markets are defined as markets in which money is provided for periods longer than a year.Capital markets channel the wealth of savers to those who can put such wealth to long-term productive use; such as companies or even governments making long-term investments. The capital is typically overseen by financial regulators or monitors such as the Nigerian Securities and Exchange Commission (SEC).

Modern capital markets are almost invariably hosted on computer-based electronic trading systems; most can be accessed only by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments. Physically the systems are hosted all over the world, though they tend to be concentrated in financial centres like London, New York, and Hong Kong.

How the Stock Exchange Operates

So many people wonder what the stock market is about. They have heard stories about people making millions by just sitting at home and investing their money, even as others have also lost money in the process of investing. Well here is to let you understand how the stock exchange works. Read carefully below-

The Bottom Line: Stocks are issued by companies to raise cash, and the stock then continues to trade on a exchange. Overall stocks have risen over the long-term, which makes owning shares attractive. There are also additional perks such as dividends (income), profit potential and voting rights. Share prices also fall, though, which is why investors typically choose to invest in a wide array of stocks, only risking a small percentage of their capital on each one. Shares can be bought or sold at any time, assuming there is enough volume available to complete the transaction, which means investors can cut losses or take profits whenever they wish.

Stock/Share: When people buy a company's stock, what that means is that they are buying a piece of the company. And whenever such a company needs to raise money, it issues shares. The raising of shares is done through what is called an initial public offering (IPO) which is the price of shares set based on how much the company is worth. People pay money to buy shares from a company after the advertisement of the IPO. And every money raised by selling the shares is then used by the company to run its business and make profit, even as the stocks or shares are traded on the floors of the Nigerian Stock Exchange. Meanwhile, some of the profits made by the company are accumulated for the shareholders who can sell their shares at any time to get their money back.

Why Buy Shares?: Traders and investors continue to trade a company's stock after the IPO because the perceived value of company changes over time. Investors can make or lose money depending on whether their perceptions are in agreement with "the market." The market is the vast array of investors and traders who buy and sell the stock, pushing the price up or down.

Why Sell Shares?: For every stock transaction, there must be a buyer and a seller. When you buy 100 shares of stock (called a "lot") someone else must sell it to you. Either buyers or sellers can be more aggressive than the other, pushing the price up or down. When the price of a stock goes down, sellers are more aggressive because they are willing to sell at a lower and lower price. The buyers are also timid and only willing to buy at lower at lower prices. The price will continue to fall until the price reaches a point where buyers step in and become more aggressive and willing to buy at higher prices, pushing the price back up.

<u>The Primary and Secondary Markets</u>

Primary Market: The primary market is where securities are created. It's in this market that firms sell (float) new stocks and bonds to the public for the first time. For our purposes, you can think of the primary market as the market where an initial public offering (IPO) takes place. Simply put, an IPO occurs when a private company sells stocks to the public for the first time. The primary market is also the market where governments or public sector institutions raise money through bond offerings. The important thing to understand about the primary market is that securities are purchased directly from an issuing company.

Secondary Market: The secondary market is also called the stock market; where investors come together to trade among themselves. Note that the investors trade on previously issued securities without the issuing companies' involvement. For example, if you buy Dangote stock, you are dealing only with another investor who owns shares in Dangote. In other words, Dangote is not directly involved with the transaction.

<u>Development Banks and their Functions</u>

Development Banks are essentially multi-purpose financial institutions with a broad development framework. Development Banks can also be defined as financial institution concerned with the provision of all types of financial assistance (medium-long term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities — economic development in general, and industrial development, in particular. Their functions include the following as enumerated below-

1. ***They promote and develop small-scale industries***
2. ***They finance the development of the industrial sector***
3. ***They facilitate the development of large-scale industries***
4. ***They help with developing the agric sector***
5. ***They work towards enhancing foreign trade***
6. ***Assist unproductive industrial units***
7. ***Encourage the efforts of entrepreneurs***
8. ***Encourage all round economic activities***
9. ***They contribute to the growth of capital markets***

ASSESSMENT

1. Define Capital Market
2. Define development banks
3. What are the functions of development banks?
4. Differentiate between primary and secondary market.

TOPIC: NATIONAL INCOME

Everything to know about National Income

National income is the total value a country's final output of all new goods and services produced in one year. The simplest way to think about national income is to consider what happens when one product is manufactured and sold. Typically, goods are produced in a number of 'stages', where raw materials are converted by firms at one stage, then sold to firms at the next stage. Value is added at each intermediate stage, and at the final stage, the product is given a retail selling price. The retail price reflects the value added in terms of all the resources used in all the previous stages of production.

ASSESSMENT

1. What do you understand by National Income?

TOPIC: Theory of Income Determination

The circular flow of income

The circular flow of income and spending shows connections between different sectors of an economy. It shows flows of goods and services and factors of production between firms and households. The circular flow also shows how national income or Gross Domestic Product is calculated. The circular flow of income can also be defined as an economic model in which the major exchanges are represented as flows of money, goods and services, etc. between economic agents. The flows of money and goods exchanged in a closed circuit correspond in value, but run in the opposite direction. The circular flow analysis is the basis of national accounts and hence of macroeconomics.

Moving on, the circular flow of income describes the flow of payments from businesses to households in exchange for labor and other productive services and the return flow of payment s from household to businesses in exchange for goods and services.

Please note the following points:

1. For easy understanding, a two sector economy which involves households and firms will be used. The household supply factors of production (input) to firms which need them for production purposes.
2. In return the household will be paid salaries and wages, interest, rents by the firms which constitute their incomes.
3. The Income is then used by the households to purchase goods and services produced by the firms. This pattern of consumption expenditure made by households constitutes income for a firm which leads to the formation of income inflow.

Factors Affecting Circular Flow of Income

1. **Injection**: Injection of fund into the circle is an increase in the incomes of households and firms beside their normal processes of selling productive resources and manufactured goods.

2. **Savings**: Savings constitute the part of income that is not spent immediately. They have the tendency of reducing expenditure of the household or firms.
3. **Withdrawal**: Withdrawal has the tendency of reducing the fund in the circular flow of income.
4. **Investment**: investment brings about an additional income leading to injection into the circular flow of income.
5. **Aids and grants**: Aids and grants from government or other sources increase the volume of fund in the circular flow of income.
6. **Import and Export**: While import involves the expenditure on foreign goods and services leading to withdrawals from circular flow of income, exports provide funds leading to injection into the circular flow of income.

Concept of consumption

Consumption can be defined as the total quantity of goods and services purchased and used by consumers during a specific period of time.

Consumption can be defined as the expenditure on goods and services at a given period of time. It is the expression of total consumer demand.

Types of consumption

1. **Durable Goods**: This involves consumption expenditure on certain items which are durable in nature, e.g houses, motor vehicles, furniture etc.
2. **Non Durable Goods**: This involves consumption expenditure on goods that are not durable in nature e.g food, clothing, water etc.
3. **Services**: This involves consumption expenditure on general services, e.g. legal fees, entertainment fees, educational fees etc.

Factors that determine the Level of Consumption

1. ***Level of income***
2. ***Interest rate***

3. ***Rate of taxation***
4. ***Profit earned***
5. ***Possession of assets***
6. ***Future expectation***

Test and Exercise

1. The circular flow of income is (a) the means by which money in circulation turns around (b) the level of people money flows to (c) It is the receipts for the payment o for services
2. The total quantity of goods and services purchased and used by consumers during a specific period is (a) savings (b) consumption (c) savings (d) income.
3. All of the following are factors that affects the flow of income except (a) injection (b) withdrawal (c) stagnancy (d) investment
4. The circular flow of income majorly is concerned with (a) how money is circulated (b) how money is spent (c) how money is save (d) has nothing to do with money.
5. All are types of consumption except (a) services (b) durable goods (c) non durable goods (d) immediate goods. *For previous lesson on Elementary Theory Of Income Determination*

TOPIC: Theory of Multiplier

The Theory of Multiplier: An Explanation

The theory of multiplier occupies an important place in the modern theory of income and employment. It states that total increase in income, output or employment is manifold the original increase in investment. Take for example- if an investment to the tune of N50,000 is made, then the income will not just be N50,000, but a multiple of the same amount of initial investment.

Therefore, if the national income increases to N150,000 due to the initial investment of N50,000, then the multiplier is equals to 3; etc. In this vein therefore, the multiplier can be seen as the ratio of increment in investment. Take note of the formular thus- ***If ΔI stands for increment in investment and AY stands for the resultant increase in income, then multiplier is equal to the ratio of increment in income (Δy) to the increment in investment (ΔI). Therefore k = ΔY/ΔI where k stands for multiplier.***

A Brief History of the Theory of Multiplier

The concept of multiplier was first of all developed by F.A. Kahn in the early 1930s. But Keynes later further refined it. F.A. Kahn developed the concept of multiplier with reference to the increase in employment, direct as well as indirect, as a result of initial increase in investment and employment. Keynes, however, propounded the concept of multiplier with reference to the increase in total income, direct as well as indirect, as a result of original increase in investment and income. Therefore, whereas Kahn's multiplier is known as 'em-ployment multiplier', Keynes's multiplier is known as investment or income multiplier.

The Equilibrium Level of Income

The equilibrium level of income has to do with a situation whereby an economy or a particular business enterprise has an equal amount of production and market demand. The equilibrium level of income can also be defined (using a microeconomic level example) as the point at which a company is able to sell all of the goods it planned to. Now having understood the macroeconomic perspective, it should be easy to now understand the macroeconomic level of the equilibrium level of income. In other words, at the the national level, gross domestic product (GDP) represents the business manufacturing its products. All the businesses, consumers, investors, and government spending in the economy represent the consumers buying those products.

How to calculate the Equilibrium Level of Income

To calculate the equilibrium level of income, you'll need a few economic figures to plug into a formula. This exercise can quickly become quite complex when factoring in government spending, inflation, GDP, and a myriad of other macroeconomic calculations. Most simply, the formula for the equilibrium level of income is when aggregate supply (AS) is equal to aggregate demand (AD), where AS = AD. Adding a little complexity, the formula becomes Y = C + I + G, where Y is aggregate income, C is consumption, I is investment expenditure, and G is government expenditure.

The formula for the equilibrium level of income is simple- when aggregate supply (AS) is equal to aggregate demand (AD); where AS = AD. Adding a little complexity, the formula becomes Y = C + I + G, where Y is aggregate **income**, C is consumption, I is investment expenditure, and G is government expenditure.

Why the Equilibrium Level of Income matters?

The calculation of the equilibrium level of income is normally a task for economists, but the application and understanding of this concept has merit for investors of all types. So pay attention and understand why this is so important- When aggregate demand exceeds aggregate supply, businesses will normally increase their output. It just makes common sense that if customers are making more and more orders, the company will most likely be inclined to increase their production to meet demand; right? But why is that you may well ask. Well the reason is because there is more money to be made! That process leads the company to buy more raw materials, invest in new equipment, and perhaps even hire more workers. The aggregate effect is very positive for the economy.

<u>What is the Multiplier effect?</u>

Every time there is an injection of new demand into the circular flow there will likely to be a multiplier effect. This is because an injection of extra income leads to more spending, which creates more income, and so on. The multiplier effect refers to the increase in final income arising from any new injection of spending. The size of the multiplier depends upon household's marginal decisions to spend, called *the marginal propensity to consume* (mpc), or to save, called *the marginal propensity to save* (mps). It is important to remember that when income is spent, this spending becomes someone else's income, and so on. Marginal propensities show the proportion of extra income allocated to particular activities, such as investment spending by firms, saving by households, and spending on imports from abroad. For example, if 80% of all new income in a given period of time is spent on Nigerian products, the marginal propensity to consume would be 80/100, which is 0.8.

The following general formula to calculate the multiplier uses marginal propensities, as follows:

1/1-mpc

Hence, if consumers spend 0.8 and save 0.2 of every £1 of extra income, the multiplier will be:

1/1-0.8

= 1/0.2

= 5

Hence, the multiplier is 5, which means that every N1 of new income generates N5 of extra income.

<u>The multiplier effect in an open economy</u>

As well as calculating the multiplier in terms of how extra income gets spent, we can also measure the multiplier in terms of how much of the extra income goes in savings, and other withdrawals. A full 'open' economy has all sectors, and therefore, three withdrawals – savings, taxation and imports. This is indicated by the marginal propensity to save (mps) plus the extra income going to the government – the marginal tax rate (mtr) plus the amount going abroad – the marginal propensity to import (mpm). By adding up all the withdrawals we get the marginal propensity to withdraw (mpw). The multiplier can now be calculated by the following general equation:

1/1- mpw

Applying the 'multiplier effect'

The multiplier concept can be used any situation where there is a new injection into an economy. Examples of such situations include:

1. When the government funds building of a new motorway
2. When there is an increase in exports abroad
3. When there is a reduction in interest rates or tax rates, or when the exchange rate falls.

ASSESSMENT

1. What is the theory of multiplier?
2. What is the Equilibrium level of income?
3. How do you calculate the Equilibrium level of income?
4. What is the multiplier effect?