COVENANT UNIVERSITY
NIGERIA

TUTORIAL KIT
OMEGA SEMESTER

PROGRAMME: ECONOMICS

COURSE: ECN 222

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ECN 222

PRINCIPLES OF ECONOMICS II

BY

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1. Why does the Aggregate demand (AD) curve slopes downwards from left to right?
2. Briefly explain four types of preferential trading arrangements between countries with relevant examples
3. State and explain three means by which a market economy activates a self-corrective mechanism
4. Using the AD/AS analyses graphically illustrate the Cost-Push inflation caused by a decrease in Aggregate supply
5. What is fiscal policy?
6. Using the AD/AS analyses graphically illustrate the Demand-Pull inflation caused by an increase in Aggregate demand
7. Provide five justification for government expenditure in any economy
8. What is your understanding of the Foreign Exchange Market?
9. Study the following information below and answer the questions that follow.

Exports/Imports	₦million
Visible exports	166,022
Visible imports	235,568
Invisible exports	20,807
Invisible imports	83,665

(i) Calculate the balance of trade. (ii) What is the current account balance? (iii) Is the country a net borrower or a net lender?

10. Write short notes on the following:

i) Balance of Payment ii) Current Account

iii) Appreciation and Depreciation of Foreign Exchange

iv) The Statistical Discrepancies Account

11. Explain the services and income accounts, and give two examples of the items under each of them respectively.
12. How many Austrian schillings will it take to buy a car which sells for $5000 in Washington D.C., if the USD price of the Austrian schilling is $0.15?
13. If 1USD cost 7.5 Austrian schillings, calculate the new cost of the car and state which of the two rates given above is more favourable to an Austrian.
14. How Does Fiscal Policy Affect the Macro Economy?
15. What is monetary policy?
16. What are the tools of monetary policy in Nigeria?
17. What is an exchange rate?
18. What are the advantages of fixed exchange rate to an economy?
19. What are the main differences and similarities between fiscal and monetary policies?
20. What are the determinants of Aggregate supply.

ANSWERS TO ODD NUMBER QUESTIONS

1. The Phillips curve is the negative empirical relationship between inflation and unemployment. It seemed to offer policymakers a "menu" of combinations of inflation and unemployment from which they could choose. The Phillips curve relationship raises some important questions about how the economy works and how macroeconomic policies should be used.
2. **Consumption Demand:** is relative stable over the business cycle, which stabilizes the economy, because of the Permanent Income Hypothesis of Milton Friedman.
   Changes in Real Interest Rates: stabilize aggregate demand (AD) and redirect economic fluctuations.
   Changes in Real Resource Prices: will redirect economic fluctuations. Real resource prices tend to fall during a recession and rise during expansion
3. Fiscal policy means the use of taxation and public expenditure by the government for stabilisation or growth. By fiscal policy we refer to government actions affecting its receipts and expenditures which we ordinarily taken as measured by the government's receipts, its surplus or deficit." The government may offset undesirable variations in private consumption and investment by compensatory variations of public expenditures and taxes.
   Fiscal policy can also be defined as "a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment." Though the ultimate aim of fiscal policy in the long-run stabilisation of the economy, yet it can be achieved by moderating short-run economic fluctuations. That is, "changes in taxes and expenditures which aim at short-run goals of full employment and price-level stability."
4. (i) To provide a socially efficient level of public goods and overcome market failure (e.g. concerns for improved and affordable access to education, health, housing)
   (ii) Government investment geared at improving human capital will raise productivity and generate gains for society
   (iii) To provide a means of distributing income and wealth (e.g. provision of welfare benefits)
   (iv) Government has a crucial role in poverty reduction and control
   (v) To provide necessary infrastructure on transport, education and health facilities
5. What is your understanding of the Foreign Exchange Market?
   The foreign exchange market is a global market where money denominated in one currency is bought and sold with money denominated in another currency.
   The foreign exchange market does not have a specific geographic location like other financial markets, as trading of currencies occurs around the globe via technology.
   Trading may be: over the counter (OTC) type, or via phone/telex/SWIFT.
   This trading does not require an actual movement of physical cash, but involves buying and selling bank deposits denominated in foreign currency.
   Participants in the FX market are major banks at the wholesale level, business customers at the retail level, and the black market (sometimes called the parallel market).
6. i) Balance of Payment : The balance of payments is a record of a country's trade in goods, services, and financial assets with the rest of the world.
   It is divided into accounts that summarize the nation's international economic transactions. The accounts are: Current Account, Capital Account, Official Reserves, Statistical Discrepancies account.
   ii) Current Account
   The current account is the sum of the balances in the following accounts:

Goods – All imports and exports of merchandise. Imports are recorded as debits, while exports are recorded as credits. The net balance is called the balance of trade.

Services – All trade involving services. E.g. travel and tourism, royalties, transportation costs, insurance premiums, e.t.c.

Income – Predominantly investment income earned form foreign investments (credits) and investment income paid to foreign companies in the country (debits). Also includes wages and salaries paid to non-resident workers.

Unilateral transfers – A one-way transfer of funds. These include foreign aid, gifts, offshore remittances and grants. Only net balances of unilateral transfers are reported.

iii) Appreciation and Depreciation of Foreign Exchange:

Appreciation of FX is a rise in the value of a currency in relation to another currency.

Depreciation of FX is a fall in the value of a currency in relation to another currency.

As a country's currency appreciates, its goods sell for higher prices in other countries, and as it depreciates, its goods sell for lower prices in other countries.

iv) The Statistical Discrepancies Account: This may be referred to as the omissions and errors account because it helps to correct for discrepancies in the other accounts.

It arises because the government cannot accurately measure all transactions that take place in the economy. A number of transactions are unaccounted for, while some are mis-calculated.

7. How many Austrian schillings will it take to buy a car which sells for $5000 in Washington D.C., if the USD price of the Austrian schilling is $0.15?

   Solution

   i) 1 Austrian schilling = $0.15
   1 USD = 1/ 0.15
   1 USD = 6. 67 Austrian schillings
   $5000 in Austrian schillings is:
   5000 x 6.67 = 33,350 Austrian schillings
   It will take 33,350 Austrian schillings to buy a car that sells for $5000.

8. Monetary policy is the process by which the monetary authority of a currency controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency. Further goals of a monetary policy are usually to contribute to economicgrowth and stability, to low unemployment, and to predictable exchange rates with other currencies.

   Monetary policy is referred to as either being expansionary or contractionary, while an expansionary policy increases the total supply of money in the economy more rapidly than usual, contractionary policy expands the money supply more slowly than usual or even shrinks it. Expansionary policy is traditionally used to try to combat unemployment in a recession by lowering interest rates in the hope that easy credit will entice businesses into expanding. Contractionary policy is intended to slow inflation in order to avoid the resulting distortions and deterioration of asset values.

9. An exchange rate is simply the price of one currency in terms of another. The process by which that price is determined depends on the particular exchange rate mechanism adopted. In afloating rate system, the exchange rate is determined directly by market forces, and is liable to fluctuate continually, as dictated

by changing market conditions. In a 'fixed', or managed rate system, the authorities attempt to regulate the exchange rate at some level that they consider appropriate. Such a system often seems appealing to those who are troubled by the uncertainties of the present, highly volatile, floating rate environment.

But the choice of exchange rate regime involves considerations that extend beyond the stability or otherwise of currency prices. This will become clearer after an examination of some fundamentals of the foreign exchange market.

10. Main Difference Between Fiscal and Monetary Policies

The main difference is that Monetary policy uses interest rates set by the Central Bank. Fiscal policy involves changing government spending and taxes to influence the level of aggregate demand.

Similarities between Fiscal and Monetary Policies

Both aim at creating a more stable economy characterised by low inflation and positive economic growth.

Both fiscal and monetary policy are an attempt to reduce economic fluctuations and smooth out the economic cycle.