# Via Afrika Economics

## Grade 12 Study Guide

C. Chaplin, I. Badenhorst, G.S.T. Mabaso, H.S.S. Tshabalala,
J.S van Zyl, J. Griesel

Via Afrika

*Our Teachers. Our Future.*

C. Chaplin

Study Guide

# Economics

## Grade 12

Via Afrika

Our Teachers. Our Future.

ISBN: 978-1-41546-308-6

# Contents

# Term1
# Topic 1 Circular flow

## Overview

This topic discusses the open economy circular flow model and the various markets that facilitate economic activities. It also deals with national accounts aggregates and conversions, and the multiplier effect in the economy.

In this topic, you will learn about:

- The open economy circular flow model
- The markets
- National account aggregates and conversions
- The multiplier

The circular flow model

- The participants
- The flows

The markets

- Goods market
- Factor market
- Financial market
- Foreign exchange market
- Flows through different markets

National account aggregates and conversions

- Basic prices
- Factor cost
- Market cost
- GNI
- GDP

The Multiplier

- Meaning of the multiplier
- The multiplier process in a two-sector model
- The multiplier effect in a graphical form
- The multiplier process in the three and four sector models

# Unit 1 The open economy circular flow model

Introduction

The circular flow model shows us how the economy functions by illustrating the relationship in the economy between production, income and spending. As consumers we have to make choices as there are scarce resources to satisfy our unlimited needs and wants.

Macroeconomics explains how the economy functions as a whole while microeconomics explains how particular and specific elements of the economy operate, for example importers, consumers, etc.

## 1. The complete diagram

The circular flow model of an open economy shows the workings of an economy that is open to foreign trade. South Africa has an open economy because we trade with other countries.

### 1.1 Participants

The flows of production, income and expenditure are influenced by four participants: households (consumers), firms (business enterprises), government (public sector) and the foreign sector.

#### 1.1.1 Households

In economics a household is any number of people that live together and make joint economic decisions. A household can consist of one person or a number of people. They sell their factors of production (productive resources) to the factor market. The factors of production are bought by firms to produce goods and services. Households spend the income they earn to buy goods and services from firms. We call spending on goods and services consumption expenditure (C). Households do not spend all their money on goods and services. They keep their savings (S) with financial institutions such as banks and insurance companies. They also pay taxes (T) to the government in various forms such as value-added tax or income tax.

#### 1.1.2 Firms

Firms produce the goods and services that are bought and consumed by other participants such as households. In order to do this they buy factors of production from households. In return for the goods and services they produce firms earn revenue.

#### 1.1.3 Government

The government buys factors of production from the factor market to produce goods and services for the public. In exchange for public goods and services, firms and households pay taxes to the government.

#### 1.1.4 Foreign sector

The foreign sector consists of imports and exports of goods and services. Importers buy goods and services from other countries, whilst exporters sell goods and services to other countries.

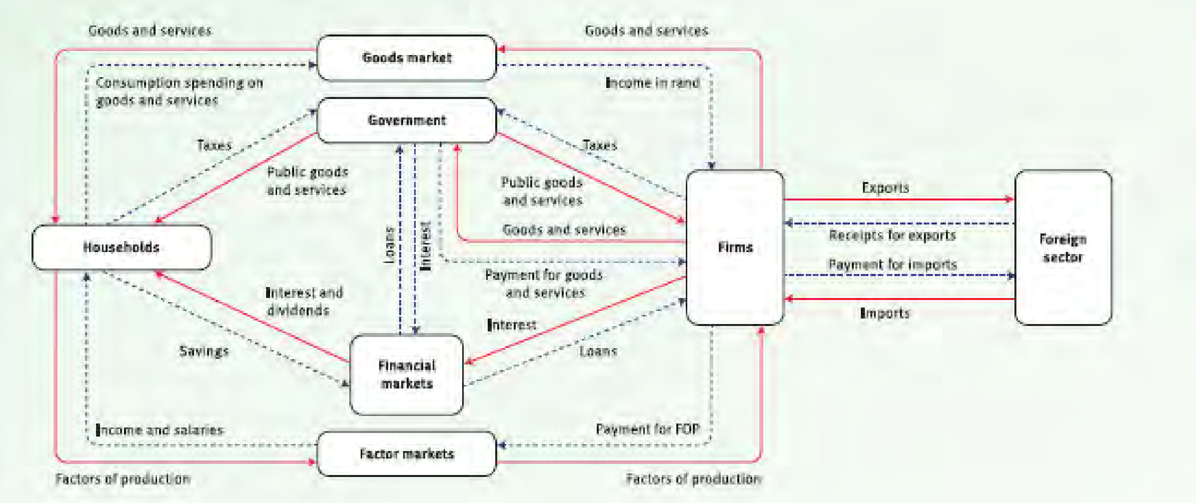



FIGURE 1.1 The circular flow model

## 1.2 Real flows and money flows

The circular flow model shows us the real flow and the money flow. The flow of goods and services between the various participants is called real flow. Examples include flows of:

- Factors of production from households to firms
- Goods and services from firms and the foreign sector to households.

  The flow of money earned and spent between the various participants is called the money flow. Examples include flows of:

  - Payment for factors of production in the form of rent, profit, wages and salaries and interest from firms to households
  - Payment for goods and services by government.

It is important to remember that for every money flow there is a real flow and that real flows and money flows move in opposite directions.

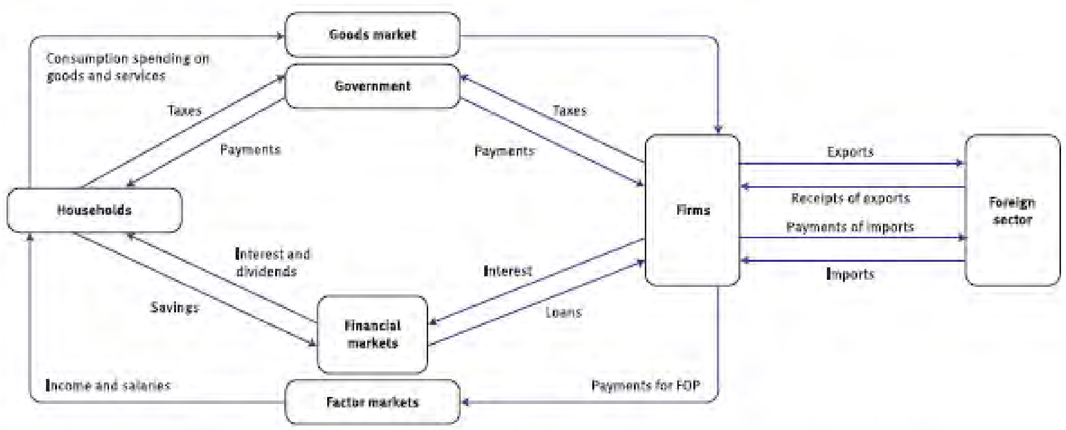


FIGURE 1.2 The flow of production, income and spending in the economy

## 1.3 Leakages and injections

There are always interruptions in both the real flow and the money flow which are caused when there are injections into the economy or leakages from it.

### 1.3.1 Leakages

A leakage happens when money leaves the circular flow and decreases the amount of money in circulation in the economy.

There are three types of leakages:

- Savings (S): Some households do not spend all their money and save some of it. This money goes to a financial institution, for example, a bank.
- Taxes (T): Households and firms pay taxes to the government, for example value-added tax (VAT) and income tax. The amount of tax decreases the disposable income of households that therefore spend less on goods and services.
- Imports (M): This represents spending on foreign goods and services. Money is withdrawn from circulation and goes to foreign markets to pay for the imports.

### 1.3.2 Injections

An injection happens when money enters the circular flow and increases the amount of money in circulation in the economy. This can happen in three ways:

- Government spending (G): The government spends money on goods and services to provide economic and social services and infrastructure, for example hospitals, schools, dams and roads. An increase in government spending increases the spending on goods and services and the flow of spending, production and income increases.
- Investment (I): This is the money spent by firms to buy capital goods. They obtain loans from financial institutions to buy plant, equipment and property. They can also use this money to build up inventories and to buy intermediate goods or raw materials. When there is an increase in investments, the flow of spending, production and income increases.
- Exports (X): Money flows into the circular flow from other countries. As more goods and services are sold to foreign countries, more foreign exchange is earned. This will increase income, spending and production.

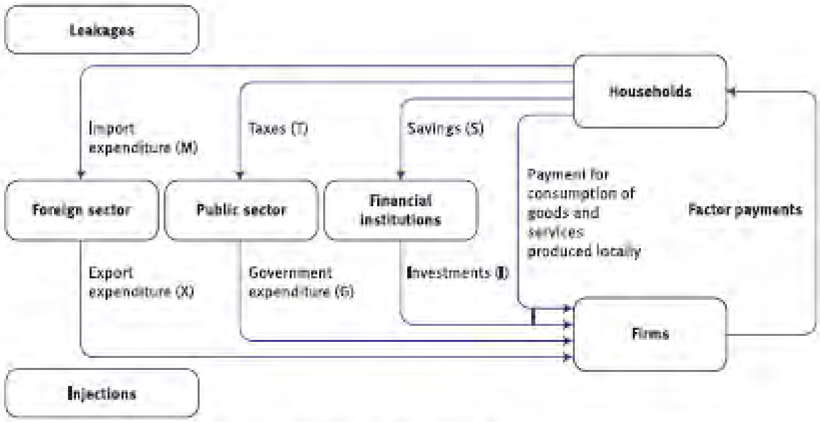



FIGURE 1.3 The leakages and injections in the economy

## 1.4 Model equations

If leakages (L) and injections (J) are equal, income will be constant.

This is expressed as follows:

L = S + T + M = G + I + X

Production, income and expenditure can be expressed as follows:

Production = income = expenditure.
P = Y = E

Gross Domestic Expenditure (GDE) is calculated as follows:

Final consumption expenditure by households (C) + Gross capital formation (I) + Final consumption expenditure by general government (G).

GDE = C + I + G, where C, I and G include imports and exclude exports.

GDP at market prices (mp)
= GDE + (X – M)
= C + I + G + (X – M)

# Unit 2 The markets

### 1. Goods market

The goods market provides goods and services in exchange for money. Households, government, firms and the foreign sector buy goods and services offered in the goods market. Although there are many different markets in macroeconomics we group all these markets together and consider the goods market as a single market. We call this aggregation.

### 2. Factor market

The factors of production are bought and sold in the factor market. The factors of production are exchanged for money.

### 3. Financial market

Financial institutions act as agents to facilitate the lending and borrowing of capital. The financial market is divided into the money market and the capital market.

- The money market is the market for short-term savings and loans.
  Short-term is defined as lasting less than a year. The South African Reserve Bank is a major institution in the money market.
- The capital market is the market for long-term savings and loans. Long-term investments and mortgage bonds are examples of capital market activities. The Johannesburg Securities Exchange is the major institution in the capital market.

### 4. Foreign exchange market

Foreign trade requires foreign currencies and these currencies can only be exchanged in the foreign exchange market. If you import goods from the United Kingdom you will have to pay for them in pounds and if you export goods to the USA you will be paid for them in dollars. The foreign exchange market determines the rate at which the foreign currencies are traded. This is called the exchange rate.

### 5. Flows through different markets

Factors of production flow through the factor markets from households to firms to produce goods and services (real flow). Goods and services flow from firms through the goods market to households (real flow). Savings flow from households to financial markets (money flow) and these savings are made available to firms in the form of loans to further production by buying capital goods (money flow). The flow of exports to other countries through the foreign exchange markets (real flow) and the income received for exports through the foreign exchange market (money flow).

# Unit 3 National account aggregates and conversions

## 1. National accounts aggregates

We can identify the national accounts as follows:

- Production refers to the gross domestic product (GDP(P)) as gross value added.
- Expenditure refers to the gross domestic expenditure (GDP(E)).
- Income refers to the gross domestic income (GDP(I)).

1.1 Deriving the national accounts aggregates

In South Africa our national accounts are prepared by the South African Reserve Bank.

1.1.1 Production

This is the GDP (P) which is the sum of all production units produced by the primary, secondary and tertiary sectors in the economy. GDP (P) is the gross value added of total output less the value of the input utilised in the production process.

1.1.2 Expenditure

Expenditure on GDP is the total expenditure on final goods and services produced within the boundaries of a country. It is calculated by adding all expenditures of the four participants in the economy (households, government, firms and the foreign sector).

1.1.3 Income

Every factor of production earns income when goods and services are produced. Therefore the total income earned must be equal to the total value of production. Gross Domestic Income (GDI) is the sum of all income earned by resident individuals or firms in the production of goods and services.

### 1.2 National account conversions

Four sets of prices are used in the national accounts: basic prices (BP), factor cost (FC), market prices (MP) and net or gross figures.

Basic prices are the initial prices in the production of final goods and services, before considering any taxes and subsidies on products and production.

Factor cost (FC) is used when GDP is calculated using the income method. The factor price represents the price received by each factor of production – rent, wages and salaries, interest and profit.

Market prices (MP) are used when GDP is calculated using the expenditure method. These are prices that consumers pay for goods and services. Market prices include taxes and subsidies.

The net figures used in national accounts have already had an amount of money subtracted from them. A net amount reflects the total after the provision for depreciation has been deducted.

National figures give information about the economic activities of the permanent residents of a country.
The Gross National Income (GNI) at market prices is calculated as follows:
GNI = GDP (MP) + primary income from the rest of the world – primary income to the rest of the world.

Domestic figures refer to all economic activities that occur within the boundaries of a country.

GDP is expressed in both nominal and real figures. Nominal figures refer to GDP figures that have not yet taken into account changes in price levels while real figures have taken these changes into account.

# Unit 4 The multiplier

## 1. Meaning of the term multiplier

An increase in the level of spending in the country results in higher GDP and a decrease in spending results in a decrease in GDP. We learned in the previous Unit that the components of GDP are C + G + I + (X – M). Therefore, an increase in any one of these components, say investment, will increase real GDP. However, the change in output (real GDP) and income will be much greater than the initial change in investment. This result is called the **multiplier effect**.

The multiplier effect is the extent of the change in real output and income that is caused by a change in aggregate demand. The size of the change in output (real GDP) and income is determined by the multiplier.

## 2. The multiplier process in a two-sector model

Consumers either spend their money or save it. The proportion spent shows the marginal propensity to consume (MPC) and the proportion saved shows the marginal propensity to save (MPS). The MPC tells us how much of their new income a person is likely to consume.

The formula for calculating MPC is:

$$\text{MPC} = \frac{\Delta C}{\Delta Y}$$

where:
ΔC is the change in consumption.
ΔY is the change in income.

The formula for calculating MPS is:

$$MPS = \frac{\Delta S}{\Delta Y}$$

where:

ΔS is the change in savings.
ΔY is the change in income.

2.1 Calculating the multiplier

We can use the multiplier as a better way of calculating the change in real GDP instead of calculating successive rounds of spending. To determine the value of the multiplier, we need to know the value of MPC. Remember the formula for MPC is ΔC ÷ ΔY.

The formula for the multiplier is:

$$k = \frac{1}{(1 - MPC)}$$

Where k represents the multiplier.

2.2 The size of the multiplier effect

How big or small will the eventual change in income be if money is injected into the economy? The answer to this question depends on the size of the MPC. The bigger the multiplier effect and the smaller the MPC, the smaller the multiplier effect. In other words, the multiplier effect has a direct relationship to the MPC.

**3. The multiplier process in the three and four sector models**

The **three-sector model** includes government. When we calculate the multiplier, we must include the effect of taxation as a leakage.

Our formula will then be:
k = 1
(MPS+MRT)

Where: MRT = is the marginal rate of taxation.

In the **four-sector model** we include the foreign sector. The multiplier is calculated by including the marginal propensity to import, MPM. The formula for a four-sector economy is:

k = 1
(MPS+MRT+MPM)

Where: MPM = is the marginal propensity to import.

## 4. The multiplier in graphical form

The multiplier can also be shown graphically

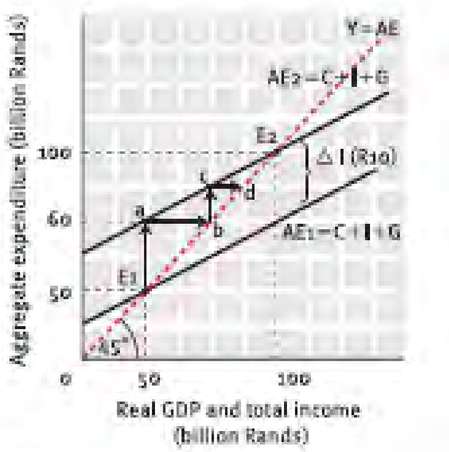



FIGURE 1.5 The multiplier process

## Questions

1. List the four participants that influence the flows of production, income and expenditure. (8)

2. Explain what is meant by the term *household* in economics. (4)

3. Explain what you understand by the term *leakage* in economics. (4

4.Explain what you understand by the term *injection* in economics. (4)

5. Give a formula for calculating the Gross Domestic Expenditure of a country. (4)

6. Explain what is meant by the economic term *aggregation*? (4)

7. Name the two parts of the financial market?. (4)

8. Why is the foreign exchange market important for importers and exporters? (4)

9. Study the following table and answer the questions:

| | 2009<br>R millions |
|---|---|
| Compensation of employees | 1 077 833 |
| Net operating surplus | 731 204 |
| Consumption of fixed capital | 332 584 |
| **Gross value added at factor cost** | **2141 621** |
| Other taxes on production | 42 101 |
| *Less:* Other subsidies on production | 9210 |
| **Gross value added at basic prices** | **2 174 512** |
| Taxes on products | 238 557 |
| Less: Subsidies on products | 14 914 |
| **Gross domestic product at market prices** | **2 398 155** |
| Final consumption expenditure by households | 1 460 911 |
| Final consumption expenditure by general government | 502 492 |
| Gross capital formation | 470 963 |
| Residual item | -15 095 |
| **Gross domestic expenditure** | **2 419 271** |
| Exports of goods and services | 657 192 |
| *Less:* Imports of goods and services | 678 308 |
| **Expenditure on gross domestic product**<br>**(GDP at market prices)** | **2 398 155** |
| Primary income from the rest of | 34 075 |

| | |
|---|---|
| the world. | |
| *Less:* Primary income to the rest of the world . | 87 593 |
| **Gross national income at market prices** | **2 344 637** |

(Source: South African Reserve Bank, *Quarterly Bulletin*, March 2012)

a. What is the difference between gross domestic expenditure and expenditure on gross domestic product. (4)
b. What is meant by gross capital formation. (2)
c. In 2009 households received R_______ for the provision of labour to the economy. (1)

d. If factor prices are used to calculate the gross domestic product then the gross domestic product was equal to R_______ in 2009. (1)

e. In 2009 the subsidies received by firms on production were R_____. (1)

f. In 2009 the taxes on products, were R______. (1)

g. In 2009 consumption spending by households was R ______. (1)

h. In 2009 the primary income South Africans earned from the rest of the world was (more, less) than the primary income we paid to the rest of the world. (1)

i) Explain why the expenditure on gross domestic product in 2009 was less than the gross domestic expenditure. (2) (14)

10. Indicate and explain whether the following variables are leakages or injections.

| Variable | Leakage or injection | Reason |
|---|---|---|
| Savings | | |
| Investment | | |
| Taxation | | |
| Government spending | | |
| Imports | | |
| Exports | | |
| | | |

(18)

# Topic 2 Business cycles

## Overview

This topic discusses business cycles, reasons for their occuring and measures the government can take to try and even out fluctuations in business cycles.
In this topic, you will learn about:

- The composition and features of business cycles
- Explanations
- Government policy
- The new economic paradigm (smoothing of cycles)
- Features underpinning forecasting with regard to business cycles.

Composition and features of business cycles

- Expansion and contraction
- Peaks, downswings, troughs & upturns
- Exogenous and endogenous factors
- Changes in business cycles

Government policy

- Fiscal and Monetary policies
- Demand and supply side actions

Forecasting

Economic indicators
-leading
-lagging
- coincident

# Unit 1 The composition and features of business cycles

### 1. The nature of business cycles

The level of economic activity in a country changes all the time. A period of high activity is called an expansion (or upswing) and a period of low activity is called a contraction (or downswing). These periods of expansion and contraction recur in a cyclical fashion. Periods of expansion and contraction in the economy are captured by a graph called the business cycle. The business cycle depicts fluctuations which occur in the economic activity of a country.

1.1 The expansion phase

This phase is characterised by growth in real GDP and income. It consists of two phases – recovery and prosperity. During the prosperity phase there is an increase in real GDP, income and employment. Businesses make high profits and this attracts other businesses to enter the market. As more businesses open, more factors of production are employed. The increase in income causes an increase in aggregate demand which in turn forces producers to increase output. This causes an increase in investment spending as producers expand their businesses and buy more inventories.

Expansion ends when it reaches the maximum point of the business cycle – the peak. The peak is the upper-turning point where the economy has reached its full capacity. It cannot grow beyond this point. This is also a point of full employment where factors of production have been fully utilised. This point is characterised by high rates of inflation.

1.2 The contraction phase

This phase is characterised by a period of gradual decline in economic activity. There is a decrease in aggregate demand that forces a decrease in output. The decrease in sales leads employers to reduce employment and income decreases. There is a downward spiral of real GDP, employment, income, and in the standard of living. The contraction period consists of two phases: recession and depression. A recession follows immediately after the peak. It is a phase where economic activity starts to slow down. It is also called the economic downturn. It occurs when there is a continuous decrease in economic activity for a period of six consecutive months (or two quarters). If a recession continues for more than two quarters, the economy enters a depression phase.

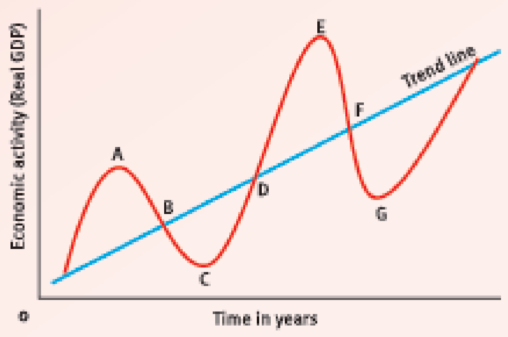



FIGURE 1.6 A typical business cycle

# Unit 2 Explanations of the business cycles

## 1. Introduction

Business cycles can be caused by factors outside the market economy (called exogenous factors) or business cycles are an integral part of the market economy (called endogenous factors).

## 2. Causes of business cycles

### 2.1 Exogenous factors

Classical economists of the 19th century believed that the market economy was always stable and that any fluctuations were caused by outside factors - exogenous factors.

Examples of exogenous factors include:

- Natural disasters
- Political reasons
- Psychological reasons
- Changes in weather patterns
- Technological innovations
- Shifts in consumer tastes and preferences.

### 2.2 Endogenous factors

The Keynesian school of thought believes that the market economy is by its very nature unstable and is characterised by periodic waves of high and low economic activity. They believe that business cycles are an integral part of the market system itself. They believe that business cycles are caused by endogenous factors that emanate from the system itself and that since the market is not able to correct this it is the governments duty to intervene.
Exogenous factors include:

- Changes in investment may put the economy into a growth or declining phase
- Changes in aggregate demand
- Changes in aggregate supply
- Technological changes and innovations
- Monetary policy changes.

## 3. Changes in business cycles

Joseph Schumpeter, the Austrian economist, documented a list of different kinds of business cycles and named them after the people who discovered them. He grouped them into short-, medium- and long-term business cycles.

- The Kitchin Cycle: discovered by the British economist Joseph Kitchin. It is the shortest business cycle and lasts for 3–5 years and is caused by changes in inventory levels.
- The Jugler Cycle: discovered by the French economist Clement Juglar, it lasts from 7 to 11 years and is caused by changes in investment in equipment and machinery.

- Kuznets Cycle: discovered by Simon Kuznets, a Nobel laureate. It lasts from 15 to 20 years and is caused by changes in infrastructural investment in housing and building construction.
- Kondratieff Cycle: is the longest cycle which lasts for 45 to 60 years. It was discovered by Russian economist, Nikolai Kondratieff. It consists of six Juglar cycles and is caused by technological changes and innovations.

# Unit 3 Government policy

**1. Introduction**

According to J.M. Keynes, the market economy cannot survive on its own and it requires government intervention to stabalize the business cycles. To counter the problems of business cycles governments can use fiscal or monetary policies.

**2. Monetary policy**

The South African Reserve Bank implements monetary policy. The Governor of the Reserve Bank, in consultation with the Minister of Finance, decides on the best policy to apply. There are two instruments of monetary policy: interest rates and money supply.

2.1 Interest rates

The Reserve Bank must try and keep inflation under control at all times. During a period of expansion, there is an increase in aggregate demand for both local and imported goods. The sudden increase in demand causes an increase in the prices of goods and services. The best monetary policy in this situation is to increase interest rates which reduces the demand and therefore slows down the increase in price levels.

2.2 Money supply

The Reserve Bank uses its supply of security instruments such as government bonds and treasury bills to control money supply. If there is too much money in circulation the SARB sells these securities to banks and other financial institutions. The SARB debits the bank’s account with the value of the sale and the bank’s balance with the Reserve Bank is reduced. This reduces the ability of the bank to offer credit. The Reserve Bank will use this policy during prosperity to mop up excess money in circulation. If there is not enough money in circulation it does the opposite.

**3. Fiscal policy**

Fiscal policy is used by the South African government to adjust its levels of spending in order to monitor and influence our economy. Its counterpart is monetary policy which is used by the central bank to influence a nation’s money supply. These two policies are used in various combinations in an effort to direct our country’s economic goals.

3.1 Taxation

By increasing taxation the government can reduce the amount of money in circulation. By lowering taxation it can increase the amount of money in circulation.

3.2 Government spending

An increase in government spending will have a multiplier effect in the economy – national income will increase by an amount far greater than the actual amount spent. Government must reduce public expenditure during prosperity when the economy is overheated as an increase in spending would only make inflation worse.

# Unit 4 The new economic paradigm (smoothing of cycles)

**1. Rationale for the new economic paradigm**

It is often difficult for difficult for governments and economists to decide when to implement new policy changes. This has prompted them to look for other ways to smooth out the impact of business cycles. The new economic paradigm offers one solution – the possibility of growth without inflation. The new economic paradigm uses two instruments, namely, demand-side and supply-side policies.

**2. Demand-side policy**

- The aggregate demand created by households, businesses and the government (C + I + G) is the driving force in the economy.
- A change in aggregate demand will have a direct effect on unemployment and inflation.
- An increase in aggregate demand forces producers to employ more labour to meet demand. As a result production and income increase but increase in demand puts pressure on the general price level. As a result, inflation increases.
- When aggregate demand decreases, producers will reduce their production. In reducing production, firms will retrench workers and decrease the income of households.
- The effect is an increase in unemployment and a decrease in inflation.

**2.1 General price level (inflation)**
The conclusion of the new economic paradigm is that when the increase in aggregate demand is accompanied by a simultaneous increase in aggregate supply, economic growth will be achieved without an increase in inflation.

**2.2 Unemployment**
An increase in aggregate demand causes firms to produce more in order to meet demand. Firms will employ more workers to increase production and will therefore reduce the rate of unemployment. A higher employment rate will give households more income and therefore more to spend on consumption. This, of course, will create inflation. This trade-off between unemployment and inflation was discovered by the economist, A.W. Phillips who developed the Phillips curve (PC).

**2.3 Stagflation**
Stagflation occurs when inflation is accompanied by stagnation in the growth rate and an increase in unemployment. During stagflation there are simultaneous increases in inflation and unemployment.

**3. Supply-side policy**

Supply-side economics stresses that economic growth depends on the stimulation of aggregate supply. The most important aspect of economic growth is the allocation and efficient use of the factors of production, especially labour and capital.

- Technical or productive efficiency. This occurs where the firm uses its resources to produce goods and services at the lowest possible cost.

- Allocative efficiency. Competition increases allocative efficiency because firms that can use their resources more efficiently can attract resources away from firms that are less efficient.

- D ynamic efficiency. This is the ability of a firm or industry to adapt quickly to changes in consumer demand and technology.

# Unit 5 Features underpinning forecasting with regard to business cycles

**1. Features**

Economists study and monitor a variety of economic variables in order to try and predict the future. The behaviour of these indicators tells them what is likely to happen in the economy.

1.1 Economic indicators

The following economic indicators are used to forecast the future direction of the business cycle:

- leading
- coincident
- lagging indicators

1.1.1 Leading indicators

Leading economic indicators change direction before the economy does. Leading economic indicators are important for investors because they are used to predict the likely future of the economy. An example are stock market returns.

1.1.2 Lagging indicators

Lagging economic indicators change direction a few quarters after the economy has already changed. They reach the turning point long after the actual business cycle has turned and confirm the change that was predicted by the leading indicators.

1.1.3 Coincident indicators

Coincident economic indicators move at the same time as changes in the economy. For example, an increase in the number of house sales indicates that the economy is entering a prosperity phase.

1.2 The length of the cycle

The length of a business cycle is a horizontal distance measured from peak to peak or from trough to trough.

1.3 The amplitude of the business cycle

Amplitude is the vertical distance between the trend line and the turning points of the business cycle.

1.4 The trend

The trend shows the general direction of the economy. It shows whether the economy is growing, remaining constant or declining over time.

1.5 Extrapolation

Extrapolation is a technique used to predict the future based on previous experience. If the economy has followed a certain path in the past, it can be predicted that it will continue doing so in the future. Extrapolation is done by extending the trend line. However, caution must be exercised because the future trend may not be affected by the same causes.

## Questions

1. What do you understand by the term "expansion phase"? (4)

2. What do you understand by the term "contraction phase"? (4)

3. Name three economic indicators are used to forecast the future direction of the business cycle (6)

4. Draw a diagram of the business cycle in which you identify the four phases of the business cycle and give a short description of each phase. (16)

5. Indicate whether the following variables increase or decrease during a contraction phase. (9)

| Variable | Contraction phase |
|---|---|
| a) Gross domestic product | |
| b) Level of economic activity | |
| c) Total spending | |
| d) Level of production | |

| | |
|---|---|
| e) Consumer spending | |
| f) Investment confidence | |
| g) Investment spending | |
| h) Imports | |
| i) Inflation | |

6. Give three reasons why an expansion phase might turn into a contraction phase. (6)

7. Differentiate between endogenous and exogenous causes of the business cycle and give an example of each. (6)

# Topic 3 Public sector

## Overview

This topic discusses the importance of the public sector and also discusses the success and failures of the public sector on South Africa. You should be able to critically discuss the problems of public sector provisioning in South Africa.

In this topic, you will learn about:

- the composition and necessity of the public sector
- problems of public sector provisioning
- objectives of the public sector and its budgets
- fiscal policy (including the Laffer curve)
- reasons for public sector failure.

The composition of the public sector

- national government
- provincial governments
- local governments or municipalities
- state owned enterprises.

→

Problems of public sector provisioning

- Objectives
- Public sector budgets
- Fiscal policy
    - *the Laffer curve*
- Reasons for failure

# Unit 1 The composition and necessity of the public sector

## 1. The composition of the public sector

The public sector consists of the following four levels of government:

- National government
- Provincial governments
- Local governments or municipalities
- State owned enterprises.

The national government is represented by the following positions: the President, Cabinet Ministers and Members of Parliament. The government is responsible for national issues such as defence and education.
The provincial government is responsible for addressing national issues within their own province. Provincial governments receive a budget from national government, but they also generate their own income, mostly from taxes.

The local government is responsible for issues that affect local communities such as roads, electricity, and sewerage and is managed by mayors and city councillors.

State-owned enterprises (SOE) are owned and managed by the state and tries to do so in the best interests of all citizens.

## 2. The necessity of the public sector

The public sector is crucial to the state. It provides the structure and law and order that allows our society to exist. The public sector determines the policies they believe will improve the living conditions and lives of all the citizens.

2.1 Need for government intervention

The private sector is motivated by profit and cannot satisfy all the needs of society. Some citizens will end up being excluded from the economic cycle and won't be able to afford to pay to satisfy their basic needs. Government intervenes through the public sector to ensure these needs are satisfied.

Government intervention is required in the following situations:

- When goods have little or no profit. The private sector is not interested in providing goods with little profit e.g. sanitation
- When very large capital investment is required. Infrastructure requires extremely large capital investments that the private sector can’t pay for.
- When the returns on capital investment are extremely long-term. The private sector does not invest in ventures that take a long time to show profits.

- To achieve political and socio-economic aims. The government provides some goods and services to address political and social issues.

# Unit 2 Problems with public sector provisioning

**1. Problems of public sector provisioning**

1.1 The problem accountability

- Economic accountability: Government is responsible for managing the economy.
- Financial accountability: State funds are controlled by the Treasury. Strict procedures must be followed when expropriating government funds.
- Political accountability: Ministers are responsible for their departments and must account to Parliament for their actions.
- Auditor-General: The annual reports of government departments need to include, among others, audited financial reports and statements of programme performance.
- Portfolio committees: In the National Assembly, there is a Portfolio Committee for each government department. Committees are responsible for monitoring the performance of their respective departments.

1.2 The problem of assessing needs

Government must be able to ensure that its citizens are able to satisfy their basic needs. To do this the government must first assess the needs of its people. The government needs to know the size of the population, their ages, and other information in order to be able to do this. They will use a number of institutions to collect and interpret this information, including census statistics provided by Statistics South Africa and surveys conducted by hospitals and schools.

1.3 The problem of efficiency

Efficiency is a problem in the public sector because efficiency is seldom measured or assessed. This situations leads to a lack of accountability and it becomes difficult to determine whether the public sector is using its skills and resources in the best possible way.

1.4 The problem of pricing policy

The aim of government provisioning is to achieve social, economic and political objectives and it is therefore not guided by profit maximisation but by social responsibility. The government gives goods and services to people free of charge which is expensive for the government.

Public goods can be one of two types: non-excludable goods or non-rival goods.

- Non-excludable goods are those goods which are consumed collectively by the community without excluding others. Non-excludable goods benefit every citizen and are not paid for directly.

- Non-rival goods do not diminish in supply for one person when another person consumes those goods.

1.5 The problem of parastatals

Without competitors, and with government funding and support, parastatals are very often inefficient with low productivity and a poor service culture. Because of the problems associated with public enterprises have led government to embark on the privatisation or restructuring of some state owned enterprises.

The following are ways that the government can privatise parastatels:

- Sale of public assets
- Contracting out/outsourcing/tendering
- Public-private partnerships
- The state stops providing a service
- Deregulation.

# Unit 3 Objectives of the public sector and its budgets

## 1. Objectives of the public sector

The public sector tries to ensure that as many people as possible enjoy a high standard of living. In order to do this the government tries to achieve the following objectives:

- To improve economic growth
- To achieve full employment or to reduce unemployment
  -In the short-run, the state can accelerate employment creation through direct employment schemes,
  - Over the medium term, the state can support labour-intensive activities,
  - In the longer run, as full employment is achieved, the state must increasingly support knowledge-intensive and capital-intensive sectors in order to remain competitive.
- To maintain price stability
- To maintain exchange rate stability
- To achieve a fair income distribution (economic equity).

## 2. Budgets of the public sector

The government uses budgets as a tool to plan and monitor its revenue and expenditure. The South African budget is divided into two categories, the Medium-Term Expenditure Framework (MTEF) and the main budget.

MTEF is a plan of estimated revenue and expenditure which runs for a period of three years.

The objectives of a MTEF are to:

- Close the gap between the financial needs for each department and what government can afford
- Remove uncertainty among ministers for the next three years
- Improve the allocation of resources to strategic priorities among departments
- Increase the level of transparency of both policy and funding so that ministries can plan ahead and programs can be sustained.

In October of each year the Minister of Finance presents a Medium-Term Budget Policy Statement (MTBPS). MTBPS is a policy statement issued by government which defines the parameters for the following year's budget. The purpose of the statement is to set the policy context and direction so that departments, provinces and municipalities can prepare their budget plans for the following three years.

On Budget Day, the Minister of Finance delivers to parliament the 'Budget Speech' and tables the Division of Revenue Bill, the national Appropriation Bill, the Estimates of National Expenditure and the Budget Review. The national budget is presented as two pieces of legislation which are introduced simultaneously:

- The Division of Revenue Bill: prescribes how revenue will be divided between the three spheres of government and the nine provinces.
- The Appropriation Bill: allocates funds to different national departments. Once it becomes an Act, it gives them authority to spend the money allocated to them.

### 3. Sources of government revenue

- Taxes: this is the main source of revenue for government
- Loans: when there is too little tax revenue to achieve objectives, the government may borrow from other countries, the International Monetary Fund (IMF) or the World Bank.
- Donations: foreign states may donate money to a government to help achieve a specific objective..
- Administrative income: this is revenue received from licences and fines.
- Commercial income: income earned for services rendered by the state.
- State property: income from mining, state forests and other government properties and assets.

# Unit 4 Fiscal policy (including the Laffer curve)

## 1. Description of fiscal policy

The two main instruments of fiscal policy are government taxation and government spending. Fiscal policy is used to stabilise the economy by adjusting the levels and allocations of taxes and government spending.

## 2. Features of fiscal policy

- Neutral fiscal policy: happens when government runs a balanced budget.
- Expansionary fiscal policy: is aimed at stimulating economic activity. It happens when government expenditure exceeds tax revenue .
- Contractionary fiscal policy: happens when the government runs a budget surplus.

## 3. Instruments of fiscal policy

### 3.1 Taxation

Taxation is the compulsory levy charged on persons, companies and goods and services in order to finance government expenditure. Taxation is applied either directly or indirectly. Direct taxation is charged on persons and business enterprise that earn an income. Indirect taxation is charged on goods and services sold.

### 3.2 Government spending

Government spending consists of government consumption and government investment.

## 4. Goals of fiscal policy

Macro-economic goals normally include the following:

- Economic growth
- Job creation
- Price stability
- Balance of payments stability
- Equitable distribution of income
- Alleviation of poverty.

Micro-economic goals are used for a single economic participant or group of participants. Sectoral goals are used to develop particular economic sectors, for example, mining.

## 5. The effects of fiscal policy

### 5.1 Economic growth

An expansionary policy may include an increase in government spending and/or reduction in taxation. These measures will leave consumers with more disposable income to spend.

5.2 Price stability

An expansionary fiscal policy may have an inflationary effect on the economy.

5.3 Exchange rates

Government can influence the exchange rate system by manipulating the value of its currency against other currencies.

5.4 Economic equity

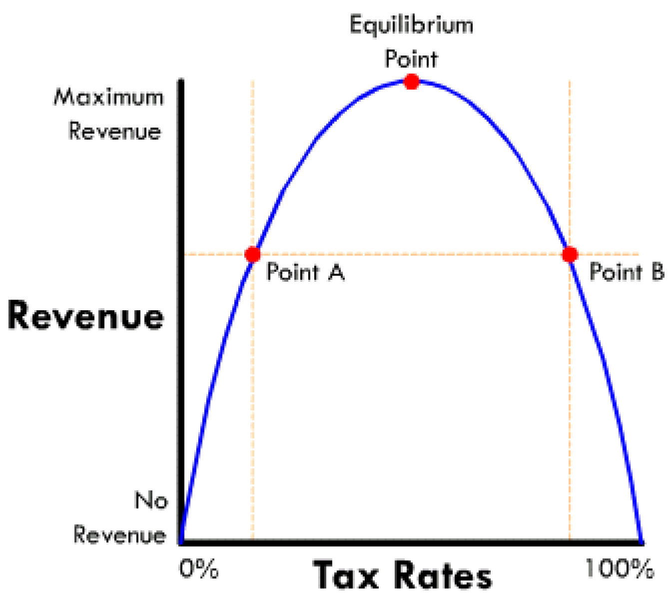
An objective of government is to ensure a fair distribution of income.

5.5 Crowding-out effect

An expansionary policy can cause a crowding-out effect in the economy. When an increase in government spending is financed by borrowing, it can cause a steep rise in interest rates. The increase can be so high that the private sector finds it difficult to compete with government in the money market.

5.6 Incentive to work and the Laffer curve

Fiscal policy impacts on the labour market by encouraging or discouraging productivity. A very high tax rate reduces people's willingness to work. This phenomenon is explained using the Laffer curve. The Laffer curve is a graph that shows the relationship between government revenue raised through taxation and the tax rate.




## Unit 5 Reasons public sector failure

**1. Description of public sector failure**

A public sector failure is a government intervention in the economy that creates inefficiencies and leads to a misallocation of scarce resources.

## 2. Features of public sector failure

The following features characterise government failure:

- Non-service delivery
- Wastefulness
- Ineffectiveness
- Lack of monitoring and evaluation
- Redundancy.

## 3. Reasons for public sector failure

3.1 Subsidies

Government sometimes provides subsidies to certain firms in order to reduce their costs of production or to encourage the production of that good and this may create barriers to entry for new firms .

3.2 Taxes

Taxes on goods and services can raise prices artificially and distort the efficient operation of the market and can discourage individuals from working hard.

3.3 Administered prices

Governments can impose minimum and maximum prices for goods. This creates distortions that lead to other problems.

- Shortages may arise when government fixes prices below the market price.
- Surpluses may be caused when government fixes prices above the market price.

3.4 Information failure

Government often lacks all the information and facts necessary to make decisions.

3.4 Bureaucracy

Excessive bureaucracy tends to cause more problems than good.

3.5 Moral hazard

If people know that they will not carry the costs, they do not take the necessary steps to reduce them and abuse the system.

3.6 Costs

Bureaucrats are not as cost conscious as people in the private sector.

3.7 Rent-seeking

All interest groups such as households, businesses, organised labour and consumers want to improve their wellbeing at the expense of government. As a result there is constant conflict between government and these interest groups.

**4. Effects of public sector failure**

Public sector failure can be categorised according to social, economic, political and environmental effects.

4.1 Social effects

- Service delivery: public sector failure is reflected most clearly in non- or poor service delivery.
- Poverty: an important government objective is to alleviate and reduce poverty.

4.2 Economic effects

- Economic growth: public sector failure is a barrier to economic growth.
- Waste of resources: the public sector is not motivated by profit and is therefore not as cost-conscious as the private sector.
- Price instability: public sector failure may lead to unstable prices for goods.
- Unemployment: the public sector must provide systems, services and policies that provide opportunities to create employment.

4.3 Political effects

- Large bureaucracy: a failing government is often characterised by a large number of bureaucrats.
- Inefficiency: a lack of monitoring and evaluation causes inefficiency, poor workmanship and low productivity in the public sector.

4.4 Environmental effects

Degradation: the failure of the public sector to implement environmental policies has caused the degradation of some of our natural resources.

## Questions

1. What does the term fiscal policy mean? (4)

2. List five goals of macro-economic policy for the public sector? (10)

3. Name two effects of public sector failure at a social level? (4)

4. Discuss the aims of the state's economic policy. (14)

5. Name four reasons for public sector failure. [8]

6. Explain the Laffer curve by using a graph. [16]

7. Discuss the problems of public sector provisioning, giving examples. [40]

8. Explain how Fiscal Policy can be used as an economic tool by the government and its effects on the economy. [16]

# Topic 4 Economic growth and development: foreign exchange market (Globalisation)

## Overview

International trade is a vital part of modern economies.

In this topic, you will learn about:

- The main reasons for international trade
- The balance of payments
- Foreign exchange markets
- The establishment of foreign exchange rates
- Corrections of BOP surplus and deficit (disequilibria).

- The main reasons for international trade
- The balance of payments
- Corrections of BOP surplus and deficit (disequilibria)

- Foreign exchange markets
- The establishment of foreign exchange rates
- Supply and demand on the forex markets

# Unit 1 The main reasons for international trade

**1. Introduction**

International trade refers to any trade between different countries in the world and is also called foreign trade.

**2. Reasons for international trade**

There are two main reasons why countries trade with each other. Firstly, a country may have an absolute advantage in the production of two different products. This means that each country can produce one of the products at a lower cost (cheaper) than its trading partner.

Secondly, countries trade because the opportunity costs involved in the production of two products are different. If one country can produce both products more economically than another country, then they will decide what to produce based on the comparative advantage in the production of the two products. The country that can produce a specific good at the lowest cost will specialise in that product. There are several reasons for comparative advantage, such as differences in technology, the availability of resources and differences in consumer tastes and demand.

# Unit 2 The balance of payments

**1. Introduction**

Many consumer and capital goods produced in other countries are consumed in South Africa. Many of the goods produced in South Africa are consumed elsewhere in the world. The term imports refer to goods and services that are produced in other countries but that are consumed in South Africa. The term exports refer to goods and services that are produced within the boundaries of a country but that are consumed elsewhere in the world. The various flows of money, goods and services between households and firms in South Africa and households and firms in the rest of the world is recorded in the balance of payments.

**2. The balance of payments**

The balance of payments is a systematic statistical account that allows a government to keep accurate records of all economic transactions between the residents in one country (in our case South Africa) and residents in the rest of the world, in a specific period of time, normally a year.

**3. The composition of the balance of payments**

The balance of payments consists of four basic accounts:

- The current account
- The capital transfer account
- The financial account
- Unrecorded transactions.

3.1 The current account

The current account reflects a number of entries. The first entry is the rand value of goods exported to the rest of the world. The next entry is service receipts and payments for services. Then income receipts and income payments. The last entry in the current account is Current Transfers.

3.2 The financial account

The financial account is the second main component of the balance of payments. This account is used to record all international financial transactions that involve assets and liabilities of a country.

3.3 Unrecorded transactions

The next component of the balance of payments is unrecorded transactions. When international trade transactions in goods and services are recorded in the balance of payments, the principle of double entry is used. However, in practice, this is seldom the case. All mistakes and omissions that were made in the process of recording the individual components of the balance of payments are entered as unrecorded transactions.

3.4 Gold and foreign reserves

When international trade takes place and products are exported, for example from South Africa to the USA, producers in South Africa want to be paid in South African rand. When goods are imported from the USA by a company in South Africa, the firm in the USA wants to be paid in US dollars. The term foreign currency refers to the different means of payment that are used to make these payments.

Gold and foreign reserves are regarded as the most important total in the Balance of payments for the following reasons:

- They reflect the overall position of the Balance of payments.
- There may be differences between the payments and receipts of foreign currency from week to week or month to month. Foreign reserves ensure the smooth flow of international trade and international finance.
- Foreign reserves stabilise the rand and prevents dramatic changes in the exchange rates of the South African rand and the other currencies. Foreign reserves reflects the ability of financial authorities to stimulate the economy without running into financial difficulty.

**Current account of the South African balance of payments**

**Annual figures (R millions)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| **Current account** | | | | | | |
| 1-Merchandise exports | 331 338 | 412 220 | 497 618 | 655 759 | 503 656 | 566 760 |
| 2-Net gold exports | 27 023 | 35 470 | 39 898 | 48 534 | 52 776 | 59 499 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 3-Service receipts | 71 808 | 82 643 | 97 110 | 105 351 | 100 760 | 102 362 |
| 4-Income receipts | 29 550 | 41 207 | 48 448 | 48 254 | 34 075 | 34 099 |
| *5-Less:* Merchandise imports | 360 362 | 476 966 | 573 850 | 739 852 | 554 161 | 598 151 |
| *6-Less:* Payments for services | 77 197 | 96 623 | 115 934 | 138 885 | 124 147 | 134 843 |
| *7-Less:* Income payments | 60 975 | 75 982 | 117 266 | 122 129 | 87 593 | 87 022 |
| 8-Current transfers | -15 680 | -15 768 | -16 575 | -18 906 | -22 428 | -16 762 |
| (net receipts +) | | | | | | |
| **9-Balance on current account** | **-54 495** | **-93 799** | **-140 551** | **-161 874** | **-97 062** | **-74 058** |

**Source:** South African Reserve Bank, *Quarterly Bulletin*, March 2011

## Unit 3 Foreign exchange markets

**1. Introduction**

When goods are imported, foreign producers must be paid using foreign currency. Businesses and individuals in other countries that buy South African products will have to pay for them in rand, and will exchange their own currencies to do so.

**2. The concept: foreign exchange markets**

A foreign exchange market brings together buyers and sellers of different currencies. The foreign exchange market consists of authorised currency dealers who buy and sell foreign currency on behalf of their clients.

The foreign exchange market is an international market that includes the buyers and sellers of foreign currency from states throughout the world.

## Unit 4 The establishment of foreign exchange rates

**1. Introduction**

The economic term rate of exchange (or exchange rate) refers to the rate at which one country’s currency is exchanged (or swopped) for another country’s currency.

**2. Interpretation of exchange rates**

The exchange rate is always given as a ratio of one country's currency in terms of another country's currency. When the exchange rate between two currencies changes, one currency will increase in value (appreciate) and the other currency will decrease in value (depreciate). There are two main exchange rates that impact the South African economy: the US dollar and the euro.

**3. Determination of the rand- dollar exchange** rate

The market for US dollars is one of the most important elements of the foreign exchange market. The general rule for dollar demand is: The higher the price of the dollar in terms of South African rand, the smaller the amount of dollars demanded. There are various sources for the supply of dollars in the South African foreign exchange market such as:

- The first is producers in South Africa who export their products to the USA.
- Foreign investors will also supply dollars when they exchange them for rands to invest in South African shares or bonds.
- Foreign tourists who bring dollars with them to South Africa and then have to exchange them to pay for goods and services.
- Speculators who expect an increase in the value of the rand will exchange dollars for rand until the rand has appreciated.

**4. Currency appreciation and depreciation due to changes in the supply and demand**

Any factor that causes a change in the demand or supply of foreign exchange will cause a change the exchange rate. When the dollar becomes more expensive against the rand, it means that more rand will be needed to buy one dollar.

| **Change** | **Impact on the exchange rate** |
|---|---|
| Increase in demand for foreign currency | Depreciates |
| Decrease in demand for foreign currency | Appreciates |
| Increase in supply of foreign currency | Depreciates |
| Decrease in supply of foreign currency | Appreciates |

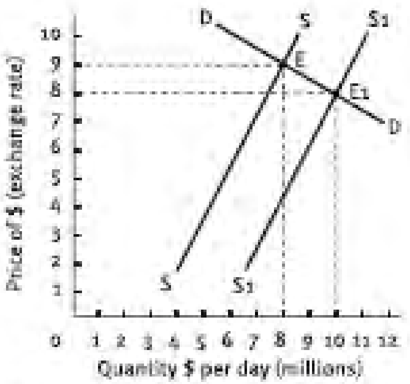



FIGURE 1.18 An increase in the supply of dollars

**5. Intervention in the foreign exchange market**

Trade in foreign exchange can be very speculative. It is common for the monetary authorities of a country to intervene in foreign exchange markets in order to limit the fluctuations in the exchange rate. Monetary authorities can intervene in two ways. Firstly, the central bank can manipulate the fluctuations in the exchange rate by means of a policy called managed floating. Secondly the exchange rate can be managed by implementing a floating currency system.

## Unit 5 Corrections of Balance of Payments surplus and deficit (**disequilibria)**

**1. Introduction**

It is in the best interest of the country if there is a balance between total imports and total exports. This balance between exports and imports will ensure that the balance of payments and the exchange rate remains fairly stable.

The sum of the balances of the current account, the capital account, unrecorded transactions and the net gold and foreign reserves of the country should add up to zero.

**2. Balance of payments surplus or deficit**

If the total payments made by the country exceed the total income received by the country in a specific period of time, the balance of payments will be in deficit. If the total income received by the country is greater than the total payments made by the country in a specific period of time, the balance of payments will be in surplus. In order to determine whether the balance of payments are in deficit or surplus, the final balances of the current account, the financial account, gold and foreign reserves of the country, as well as unrecorded transactions, must be added together.

2.1 The current account

- The total income on the current account is calculated by determining the sum total of merchandise exports, net gold exports, service receipts and net receipts of current transfers.
- Total payments from the current account are calculated by determining the sum total of merchandise imports, payments for services and income payments
- The balance of the current account is the difference between total income and total payments in the current account.
- The current account will be in deficit if total payments in the current account exceeds (or is greater than) total income in the current account.
- The current account will show a surplus when the total income of the current account is greater than the total payments in the current account.

2.2 The financial account

- The balance of the financial account is determined by calculating the sum total of net direct investment, net portfolio investment and net other investment.
- The financial account will have a surplus if the inflow of capital exceeds the outflow of capital for a specific period.
- The financial account will have a deficit when the outflow of capital exceeds the inflow of capital in a specific period.

## Questions

1. List the reasons why countries trade with one another. (6)
2. Distinguish between the law of absolute and comparative advantage. (4)
3. Briefly explain how a flexible exchange rate corrects a deficit on the current account of the balance of payments. (6)
4. Complete the table below by indicating whether the following events will cause a rightward or leftward shift of the demand or supply curve for dollars. Indicate whether the rand/dollar exchange rate depreciates or appreciates. (14)

| **Event** | **Shift** | **Depreciation or appreciation of the rand/dollar exchange rate** |
|---|---|---|
| a) An increase in the number of tourists visiting South Africa this year | | |

| | | |
|---|---|---|
| | | |
| b) An increase in the international demand for gold from South Africa | | |
| c) An increase in the amount of capital goods that South African firms buy from the rest of the world | | |
| d) An increase in the amount of imports bought by households | | |
| e) A decrease in the amount of foreign bonds bought by South Africans | | |
| f) A decrease in fixed investment by foreigners in South Africa | | |
| g) An increase in the amount of South African bonds bought by foreigners | | |

5. Choose the correct option in brackets:

a) If the inflow of foreign currency exceeds the outflow of foreign currency the foreign reserves (*decline/increase*).

b) An increase in foreign reserves indicates that the inflow of foreign currency is (*more/less*) than the outflow of foreign currency.

c) If the combined balance on the current and capital account is positive, foreign reserves (*increase/decrease*).

d) A deficit on the current account coupled with a deficit on the financial account

(*increases/decreases*) foreign reserves.

e) If the deficit on the current account is larger than the surplus on the financial

account foreign reserves (*decline/increase*). (10)

**TERM 2**

# Term2

# Topic 1 Economic systems: protection and free trade (globalisation)

## Overview

This topic looks at ways in which local trade can be protected from competition and also the advantages and disadvantages of globalisation.

In this topic, you will learn about:

- Export promotion
- Import substitution
- Protectionism (the arguments)
- Free trade (the arguments)
- A desirable mix
- Evaluation.

Export promotion

- importance
- consequences
- methods of promotion

Import substitution

- methods
- reasons

Free trade

- arguments for free trade
- arguments against free trade

Evaluation of South Africa's policies

- Marakesh agreement
- SACU
- Cotonou Protocal
- GSP
- SACU
- WTO
- Cairns Group
- World economic Forum

# Unit 1 Export promotion

**1. The concept**

- International trade is the buying and selling of goods and services between one country and another.
- We call goods bought into the country imports and those sold to another country as exports.
- Free trade occurs when imports and exports flow freely between different countries of the world.
- Although free trade has its advantages it is not accepted as being beneficial to everyone.
- Strong foreign competition can cause countries to impose trade barriers to protect their local industries. We call this protectionism.
- Two strategies can be followed to overcome this problem: export promotion and import substitution.

Export promotion means that the government assists and encourages local firms to sell goods and services in international markets. Producers in South Africa can apply for these incentives from the Department of Trade and Industry (DTI). An example of such an incentive is the Export Marketing and Investment Assistance (EMIA) scheme. Administered by the DTI it compensates exporters for the costs involved in developing export markets for South African goods.

**2. The importance of export promotion**

- Exports help stimulate economic growth.
- Exports help pay for imports and improve the position of the balance of payments.
- The increase in demand leads to larger scales of production which in turn leads to a decrease in production costs, called economies of scale, which will make local producers more competitive internationally.

,

**3. The consequences of export promotion**

- It allows both local producers and the South African government to strengthen their relationships with trading partners.
- Strong relationships result in trade, investment and advances in technology that are beneficial to all concerned.

**4. The promotion of exports**

- Incentives and subsidies can help promote exports.
- Incentives are measures offered to producers to encourage them to export their products. An example of an incentive is a scheme run by the IDC that makes finance available at reduced rates for certain business expansion schemes that are expected earn increased foreign exchange .
- Subsidies are cash payments made to exporters to encourage the export of their goods and services.

# Unit 2 Import substitution

**1. The concept**

Import substitution occurs when the government of a country encourages the use of locally made goods and services rather than imported ones. This helps promote the growth of local industries thereby promoting economic growth.

The government uses the following import controls to encourage import substitution:

- Import tariffs
- Import quotas
- Custom duties.

**2. The reasons for import substitution**

Reasons for import substitution include the following:

- It is easier for producers to enter an identified market if the domestic market is protected.
- To solve balance of payments problems
- To develop the local manufacturing industry. This will create additional job opportunities because the secondary sector is the largest employer of all sectors.

# Unit 3 Protectionism (the arguments)

**1. The concept**

Protectionism means the implementation of trade policies aimed at restricting the importing of certain goods and services in order to protect local industries.

**2. Arguments in favour of protectionism**

- Protecting infant (new) industries: If a new industry is protected in its early years it may be able to grow and become competitive later on.
- Stable wage levels and standards of living: Countries with low wage levels are able to export their goods to other countries at low prices thereby threatening the existence of the local industries.
- Trade restrictions and unemployment: When a country suffers from a high level of unemployment there will be pressure to impose trade restrictions to protect local industries.

- Preventing dumping: In the short term local consumers are able to buy goods cheaply but in the long run it leads to reduced choice and higher prices the foreign firm is able to charge because they have forced the local producers out of business.
- Protecting strategic industries and encouraging self sufficiency: Some industries are essential for a countries survival and as such must be protected.
- Balance of payments corrections and stabilising the exchange rate: Protectionism can be used to reduce imports thereby improving the balance of payments and exchange rate.
- Earning government revenue: Import tariffs are a important source of revenue.
- Multinational companies: Multinational companies can dominate less developed countries.

# Unit 4 Free trade (the arguments)

**1. The concept: Free trade**

Free trade refers to the flow of exports and imports between different countries in the world free from any interference from trade barriers with no forms of protection being used to protect new industries in developing countries.

Benefits of free trade are:

- It leads to a decrease in the domestic prices of goods and services.
- It encourages the development and use of more efficient methods of production.
- It exposes domestic consumers to new products.
- It provides domestic consumers with a wider range of consumer products.

**2. Arguments in favour of free trade**

- Improves global efficiency: Resources are allocated more efficiently as markets expand.
- Specialisation: Free trade allows countries to specialise in industries where they have a competitive advantage.
- Economies of scale: Costs can be significantly reduced if businesses take advantage of the economies of scale a global market offers.
- Innovation: Increased competition encourages innovation.
- Spreads democratic values: Businesses that trade on an international basis have to comply with international law.
- Choice: Consumers are free to buy goods and services from anywhere in the world.
- Lower prices: Specialised production and an efficient allocation of resources leads to lower prices.

# Unit 5 A desirable mix

**1. Introduction**

Most countries use a combination of both free trade and protectionism. Globalisation means that no country is excluded from international trade.

**2. What is the desirable mix?**

- The worlds economy is characterised by globalisation and international trade. All countries are encouraged, especially developed countries, to implement a free trade policy. In theory, the removal of all trade barriers will provide the best conditions for international trade.
- In reality, however, international markets are not perfectly competitive and the theory, on which free trade is based, does not resemble conditions in the real world. It is sometimes necessary to use some protectionism to achieve national objectives. When a protectionist trade policy such as a trade tariff is implemented, an economy is likely to suffer economic losses. However, the state may benefit in other ways such as by protecting jobs.
- Countries sign international agreements that establish trade protocols which dictate how international trade will take place. Examples include the African Union (AU) and the European Union (EU).
- The World Trade Organization (WTO) is the only international global organisation that deals with the rules of trade between countries. It seeks to reduce worldwide trade barriers so that more countries benefit from international trade.

# Unit 6 Evaluation

**1. Introduction**

South Africa's economic policy emphasises that exporting goods will stimulate economic growth. South Africa has signed an agreement with the WTO to liberalise trade. The government has used a Proudly South African campaign to encourage South African consumers and foreign visitors to buy locally produced goods.

**2. Free trade or protectionism for South Africa?**

In 1994, South Africa signed the Marrakesh Agreement indicating that it had adopted a Free trade approach. In doing so, South Africa made a commitment to open international trade by lowering subsidies and exchange controls.

South Africa participates in the following organisations and agreements with the aim of developing more free trade and development:

- Southern Africa Development Community Protocol on Trade.
- Southern African Customs Union (SACU).
- Cotonou Agreement – this is an agreement aimed at the reversal of economic and technological marginalisation of Africa, Caribbean and Pacific group countries in terms of global trade and investment
- United States Generalised System of Preferences (GSP) which grants duty free treatment for more than 4 650 products
- SACU-China FTA negotiations
- World Trade Organisation (WTO)
- Cairns Group – this is an association of countries that export agricultural products with the objective of free and fair trade in the global agricultural market.
- World Economic Forum – the annual meeting of world economic leaders in Switzerland has become the world's global business summit.

## Questions

1. What does the phrase f*ree trade* mean? (2)

2. What does the phrase *export promotion* mean? (2)

3. What does the phrase *import substitution* mean? (2)

4. List seven advantages of free trade. (14)

5. Discuss the various protocols that South Africa has signed since 1994. (16)

6. Write a brief note on the advantages of import substitution. (16)

7. Discuss four arguments in favour of protectionism. (16)

8. Explain any three disadvantages of import substitution. (6)

# Topic 2 Dynamics of markets: perfect markets

## Overview

This topic examines perfect markets and how well they answer the basic economic questions of:
What to produce? How to produce? For whom to produce?

In this topic, you will learn about:

- Perfect competition
- Individual business and industry
- Market structure
- Output
- Profits
- Losses and supply
- Competition policies.

Characteristics of a perfectly competitive market

- Many buyers and sellers
- Homogeneous
- Perfect information
- No collusion
- Freedom of entry and exit
- Unregulated
- Mobility of factors of production.

Individual businesses and the industry

- The difference between the industry and the individual business
- The different revenue concepts and curves of the business in a perfectly competitive market
- The different cost concepts and curves of the businesses in a perfectly competitive market.

Output decisions

- Profit maximisation for a firm under perfect competition in the short-run
- Market price changes in the short-run
- Long-run costs of the individual business.

Market structure

Organisation of a perfectly competitive market.

# Unit 1 Perfect competition

**1. Introduction**

In economics we are looking for ways in which our scarce resources are used efficiently to produce goods and services that satisfy our needs and wants. In a market economy businesses produce goods and services. The way in which they will behave is influenced by the market structure they find themselves in. In this unit we are looking at how they behave under perfect competition. In Grade 11 you learnt that when a market is perfectly competitive, there are many relatively small businesses that produce or manufacture homogeneous (identical) goods or services. None of these businesses has the power to influence or change the price at which the product is sold. Where there is perfect competition the market price of the product is determined through the interaction of demand and supply.

**2. Characteristics of perfect competition**

- Many buyers and sellers: For a perfectly competitive market to exist there must be many buyers and sellers of a specific product. This ensures sufficient competition so that no buyer or seller can influence the products price.
- Homogeneous product: The products must be similar or identical to ensure that no seller can distinguish his product from his competitors which would allow him to charge a higher price. As long as the products are homogeneous there is no reason for a buyer to prefer one product over another.
- Perfect information: All the buyers and sellers must have complete and correct information about the market conditions.
- No collusion: Each buyer and seller must act independently thereby avoiding collusion.
- Freedom of entry and exit: Buyers and sellers must be free to enter or leave a market. There must be no barriers to entry allowing new businesses to enter and compete against existing ones.
- Unregulated market: There must be no government interference.
- Mobility of the factors of production: The factors of production must be free to move from area and industry to others.

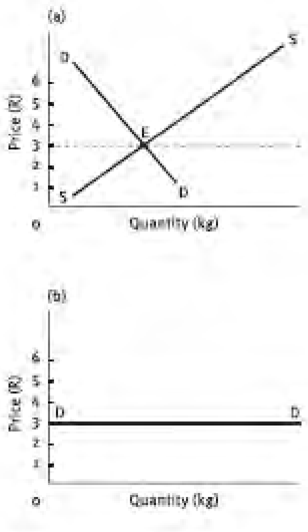



FIGURE 2.2 The individual business as price-taker

In perfect competition the individual firm is a price taker and must sell its product at the market price

New suppliers are able to enter the market, due to the existence of profits and therefore supply will increase and the price will decrease until a new equilibrium price and quantity is reached.

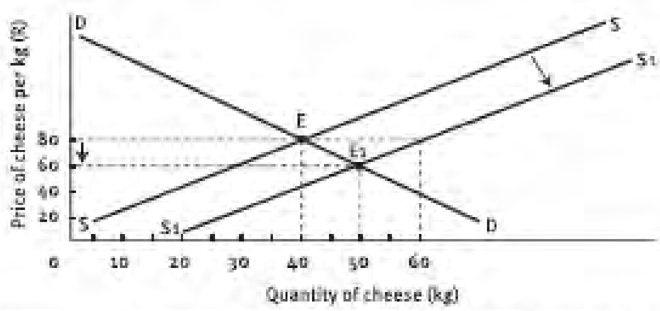



FIGURE 2.3 Impact of new producers joining the market as a result of a large profit

## Unit 2 Individual business and industry

**1. Introduction**

We can define an industry as being all the businesses that produce the same good or service. The industries output will be sum total of the output of all the individual businesses. Different industries will have different sizes. An individual business is a single producer of a specific good or service.

The way in which businesses behave within an industry depends on how the industry is organised. The economic term market organisation refers to the way in which the industry is organised. This will include amongst other things the ability of a business to influence prices (price-maker).

**2. The difference between the industry and the individual business**

2.1 The industry

As mentioned above an industry consists of all the different businesses that produce the same product. If all products are homogeneous (similar) they will all be sold at the same market price. However, even though the products produced by an industry are exactly the same, there are other products that can be used to replace a product to satisfy the same need. All products have a substitute product that can replace them.

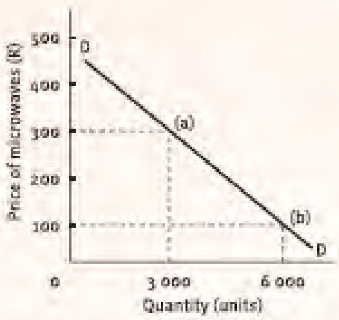



FIGURE 2.4 The demand curve for microwave ovens

2.2 The individual business

Individual businesses don't have any influence on the market price for which they sell their homogeneous products.

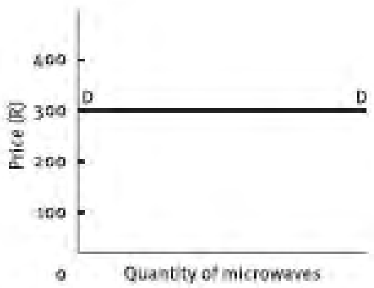



FIGURE 2.5 The demand curve for microwave ovens of the individual business

**3. The different revenue concepts and curves of the business in a perfectly competitive market**

We will be looking at the following revenue concepts:

- Total revenue (TR)
- Average revenue (AR)
- Marginal revenue (MR).

Total revenue (TR) refers to the total income received when a business sells a specific quantity of goods or services at the market price.

It can be calculated as follows:

TR = Price × quantity sold.

Average revenue (AR) is equal to total revenue divided by the quantity sold.

The equation is: AR = TR ÷ quantity sold.

Marginal revenue (MR) is defined as the additional or extra revenue earned when one additional unit of the product is sold. We use the following equation to calculate marginal revenue:

MR = (New TR – previous TR) ÷ (New quantity sold – previous quantity sold)

The following example shows the relationship between the different revenue concepts :

| **Quantity Q** | Price (P) | Marginal Revenue (MR) | Total Revenue (TR) | Average Revenue (AR) |
|---|---|---|---|---|
| 0 | 5 | | 0 | |
| 1 | 5 | 5 | 5 | 5 |
| 2 | 5 | 5 | 10 | 5 |
| 3 | 5 | 5 | 15 | 5 |
| 4 | 5 | 5 | 20 | 5 |
| 5 | 5 | 5 | 25 | 5 |
| 6 | 5 | 5 | 30 | 5 |

**Revenue curves**

Revenue curves are a graphic representation of the total revenue, average revenue and marginal revenue of a firm or an industry. By examining the curves on the curve we can easily see what is happening to revenue over a period of time.

**Profit maximisation**

In perfect competition the firm maximises profits if it produces that quantity where the marginal revenue (MR) is equal to the marginal cost (MC).

MR = MC → profit maximisation

As long as the marginal revenue is greater than the marginal cost, the marginal revenue contributes towards total profits. By producing and selling an additional unit, the producer gains more than it costs to produce the additional unit and its profits increase.

MR > MC → profits increase

When marginal revenue is less than marginal cost total profits will decline. It is costing the firm more to produce the additional unit than it gets from selling the additional unit. It is therefore not in the interest of the firm to produce the extra unit.

MR < MC → profits decline

**4. The different cost concepts and curves of the business in a perfectly competitive market**

- In order to receive revenue, businesses must incur costs. These costs can be expressed at total costs, average costs or marginal costs.
- There is a short run and a long run for businesses.
- Short run costs can be divided into fixed costs and variable costs
- Fixed costs (FC) plus variable costs (VC) = total costs (TC). (FC + VC = TC)
- In the short run fixed costs cannot be changed. In the long run all costs are variable.

**Cost concepts**

Costs can be shown graphically in the same way as revenue curves

Total costs (TC): the total cost of production including variable and fixed costs.
TC = TFC + TVC

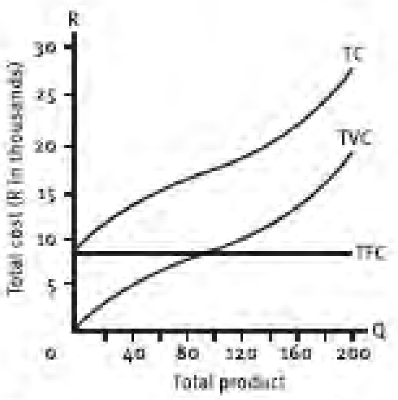



FIGURE 2.10 The TC, TVC and TFC cost curves

Average costs (AC or ATC): the total cost per unit.
AC = TC ÷ number of units produced. Also,
AC = AFC + AVC.

Average fixed costs: total fixed costs divided by the number of units produced.
AFC = TFC ÷ number of units produced.

Average variable costs: total variable costs divided by the number of units produced.
AVC = TVC ÷ number of units produced.

Marginal costs (MC): the change in total costs if one extra unit of output is produced.
MC = Change in TC ÷ Change in Quantity produced.

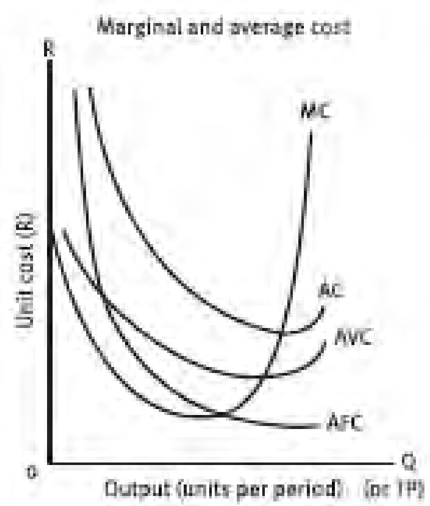



FIGURE 2.14 AC, AVC, AFC and MC cost curves

## Unit 3 Market structure

**1. Introduction**

Perfect competition (i.e. a market structure allowing for competition) as the most efficient market structure because it ensures that:

- Goods and services are produced at the lowest cost

- Scarce resources are used in the most efficient manner.

The conditions needed for a perfect market to exist are not always possible in the real world resulting in many different market structures. We can distinguish between the following basic market structures:

- Perfect competition
- Monopolistic competition
- Oligopoly
- Monopoly.

The following four characteristics are used to distinguish between the different market structures:

- The number of buyers and sellers in the market.
- The nature of the product.
- The availability of information.
- The freedom to exit from or enter the market

**2. The organisation of the perfectly competitive market**

- The number of buyers and sellers in the market

The quantity demanded by consumers depends on a variety of factors such as the their ability to pay for the product, the type of need or want satisfied by the product, the price of the product and the size of the population. Since all products in a perfectly competitive market are homogeneous there will be a large number of buyers who will demand the product. None of these buyers, however, can influence the market price of the product since the quantity each demands is small compared to the total market demand for the product.

- The nature of the product

Homogeneous products are goods or services that are exactly the same and here is no reason why consumers will prefer one to another.

- The availability of information

In a perfectly competitive market all individual businesses and consumers have perfect knowledge. This means that no individual businesses can benefit, at the cost of the other businesses.

- Exit and entry to the market

In a perfectly competitive market, all producers and suppliers are free to enter the market at any time.

# Unit 4 Output

## 1. Introduction

In a perfectly competitive market a business's objective is to maximise its profits. As an individual business it cannot change the products price and needs to decide if:

- It should continue with production or close down its operations
- The quantity that it needs to produce to maximise its profits.

We use the term output to describe how many products the business will produce and sell at this market price to maximise its profits.

## 2. Maximum profit for a business under perfect competition

There are two ways a producer can decide how much to produce:

- The marginal revenue - marginal cost rule: This says that the business should produce that level of production where marginal revenue equals marginal cost. (MR = MC)
- Total revenue - total cost approach: Produce the level of output where the positive difference between the total revenue and the total cost is the greatest.

## 3. What happens when the market price changes in the short-run?

If the market price changes, the business will have to adjust its decision on the quantity of goods they will produce and sell. According to the profit maximising rule, they will always produce the quantity where the MR = MC.

## 4. Long-run costs of the individual business

The long-run is a period of time long enough for a business to change all of its factors of production and inputs in order to adjust its level of output. In the long-run, the business does not have fixed costs. All costs are variable. The total costs of the business in the long-run are therefore equal to the total variable costs (TC = TVC)

The relationship between the LRAC and the LRMC is the same as the relationship between the SRAC and SRMC.

The long-run average cost curve of the business is U-shaped. This implies that as the level of output increases initially, the long-run average costs (LRAC) will decrease.

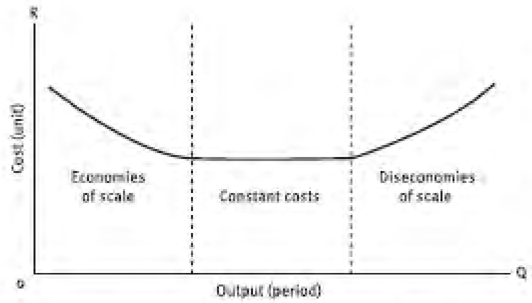



FIGURE 2.16 The long-run average cost curve of the business

**5. Optimum size of the business in the long-run**

A business operating in a perfectly competitive market structure will try to maximise its profit in the long-run. Businesses will continue to expand as long as there are economies of scale that can be realised.

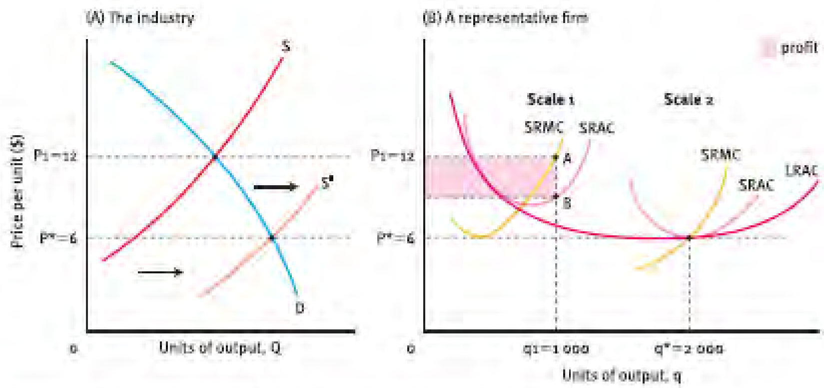



FIGURE 2.18 Optimum size for a business under perfect competition

# Unit 5 Profit

- Profit is the difference between the total revenue and total costs. The business makes a profit when the total income exceeds the total costs of the business.

- Normal profit is the best return that the businesses self-owned, self employed resources could earn elsewhere and can be regarded as the minimum payment required by the owner of the business to stay in that particular business.

- Economic profit is equal to the total revenue that exceeds the total cost. It is the extra profit the owner of the business receives above the minimum payment required to stay in that particular business.  This is why it is sometimes called excess profit or pure profit.

### 2 Maximum profit according to the marginal revenue and marginal cost approach

Businesses can use the  marginal revenue–marginal cost approach to determine the maximum level of output. Profit is maximised when MC = MR

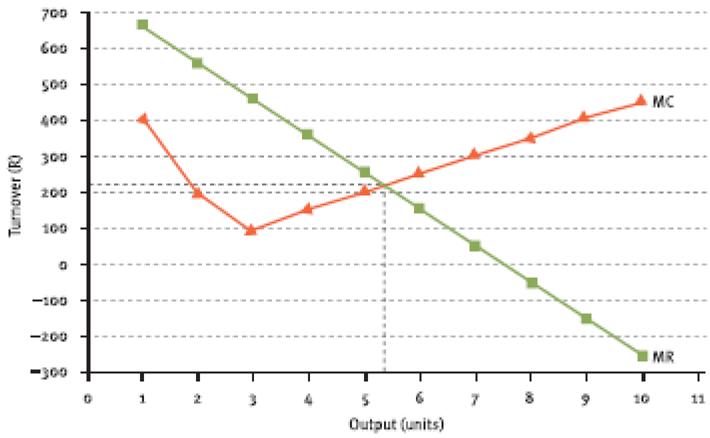



FIGURE 2.20 The marginal revenue–marginal cost approach

### 3 When does a business make an economic profit?

If MR is greater than MC then the business is making an economic profit

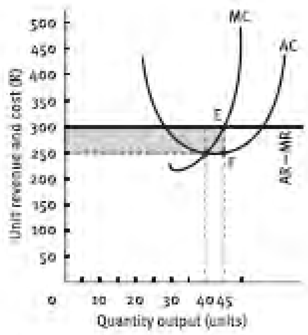



FIGURE 2.21 The business realising an economic profit

# Unit 6 Losses and supply

### 1. Introduction

Under perfect competition, the market price is determined through the interaction of demand and supply . If market forces change and the market price decreases, there is nothing that the business can do to influence the market price. The only thing that the business can do is to change the level of output to limit any loss that it may suffer.

An economic loss occurs when the average cost of the business is greater than the average market price. The profit maximising rule states that if the business wants to maximise its profit (or minimise its loss), the firm must produce that level of output where the marginal revenue is equal to the marginal cost.

**2 What happens if the market price decreases? When will the firm close down?**

As long as the price is equal to or higher than average cost per unit the firm makes a profit. *If* the price falls below the average cost per unit and total revenue is less than total cost the firm makes a loss.

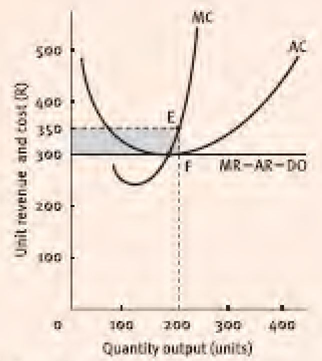



FIGURE 2.22 A business making an economic loss under perfect competition

According to demand and supply analysis, as more firms enter the market, the supply increases and the supply curve shifts to the right, so the price of the product decreases. As the price of the product decreases, the firm will receive less in total revenue, and economic profits will start to decline. This process will continue until only normal profits are earned in the market.

When firms in a particular market make a loss it is time to consider leaving the market. As more and more producers leave the market the supply will decrease. In terms of demand and supply analysis, this will cause an upward shift of the supply curve and the price will increase. Firms that stayed in the market will now be able to earn only a normal profit.

It is through changes in the market price and the entry and exit of firms that ensures that an efficient allocation of resources takes place in a perfect competitive

# Unit 7 Competition policies

Governments use competition policy to try and improve the efficiency of the markets because resources are scarce and our needs are unlimited. Competition policies in South Africa aim to:

- Increase the markets efficiency
- Trying to give previously disadvantaged people equal opportunity to participate in the economy
- Contribute to developmental objectives.

The government introduced the Competition Act 1998, its aim is to promote and maintain competition in South Africa to achieve the following:

- To promote the efficiency, adaptability and development of the economy.
- To provide consumers with competitive prices and product choices.
- To promote employment and advance the social and economic welfare of South Africans.
- To expand opportunities for South African participation in world markets and to recognize the role of foreign competition in South Africa.
- To ensure that small and medium-sized enterprises have an equal opportunity to participate in the economy.
- To promote the spread of ownership and to increase ownership stakes of historically disadvantaged people.

The government created the following institutions to help achieve the Acts objectives:

- The Competition Commission: It is empowered to investigate, control and evaluate restrictive business practices, any abuse of dominant positions and mergers to achieve equity and efficiency.
- The Competition Tribunal: Amongst other things it has the power to authorise or prohibit large mergers.
- The Competition Appeal Court: It has the power to appeal or review any decision made by the Competition Tribunal.

## Questions

1. List seven characteristics of perfect competition? (14)

2. What is the difference between normal profit and economic profit? (8)

3. a) Use demand and supply curves to show what would happen on the market for potatoes if the demand for potatoes increases. (4)

b) Show how the above change in the market for potatoes will influence the demand curve for the individual producer of potatoes. (2)

4. Use the table below to fill in the main differences between the different types of markets.

| **Structure** | **Number of firms** | **Characteristics of product** | **Market power** | **Entry and exit** |
|---|---|---|---|---|
| Perfect competition | | | | |
| Monopolistic competition | | | | |
| Oligopoly | | | | |
| Monopoly | | | | |

(16)

5. Complete the following table below and show where the firm will maximise its profits.

| **Quantity (Q)** | **Price (P)** | **Marginal Revenue (MR)** | **Marginal Cost (MC)** | **Contribution to profits** |
|---|---|---|---|---|
| **1** | **6** | | **2** | |
| **2** | **6** | | **3** | |
| **3** | **6** | | **4** | |
| **4** | **6** | | **5** | |
| **5** | **6** | | **6** | |
| **6** | **6** | | **7** | |
| | | | | |

(8)

7. Draw a demand curve for an individual producer under perfect competition and indicate the marginal revenue and average revenue. (4)

8. Explain why, under perfect competition, economic profits by individual producers will eventually decline. (4)

9. What are the main aims of competition policy in South Africa? (4)

# Topic 3 Dynamics of markets: imperfect markets

## Overview

In this topic, you will learn about:

- The dynamics of imperfect markets with the aid of cost and revenue curves
- Monopolies
- Oligopolies
- Monopolistic competition.

Imperfect markets

Technical inefficiency

Monopolies

- Characteristics
- Profits
- Short and long run profits.

Oligopolies

- Characteristics
- Profits
- Short and long run profits.

Monopolistic competition

- Characteristics
- Forms of competition
- Profits
- Short and long run profits.

# Unit 1 The dynamics of markets with the aid of cost and revenue curves

**1. Description of imperfect markets**

The two concepts of efficiency that we use in economics are technical efficiency and allocative efficiency.

- Technical efficiency is when the market produces the maximum quantity of goods and services from the available resources.
- Allocative efficiency occurs when the market produces the best mix of goods and services that the consumers desire.

Under perfect competition the forces of demand and supply create allocative efficiency is reached and technical efficiency is ensured by competition between businesses.

The conditions for perfect competition are rarely met in the real world and imperfect competition is more common than perfect competition. There are three types of imperfect markets: the monopoly, the oligopoly and monopolistic competition.

# Unit 2 Monopolies

**1. Introduction**

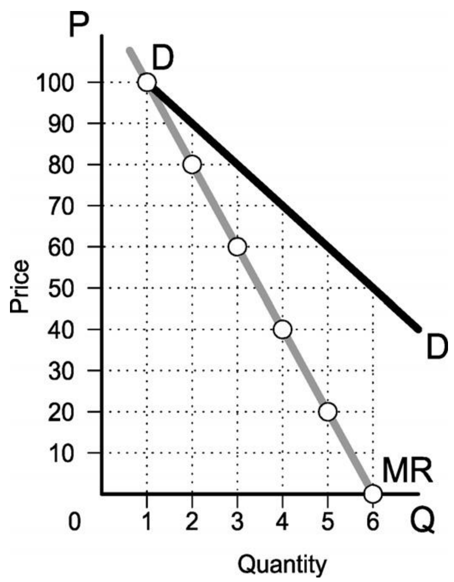
A monopoly exists when there is only one seller of a good or service for which there is no substitute and it is impossible for another business to enter the market. it is the opposite of perfect competition.

**2. Characteristics of a monopoly**

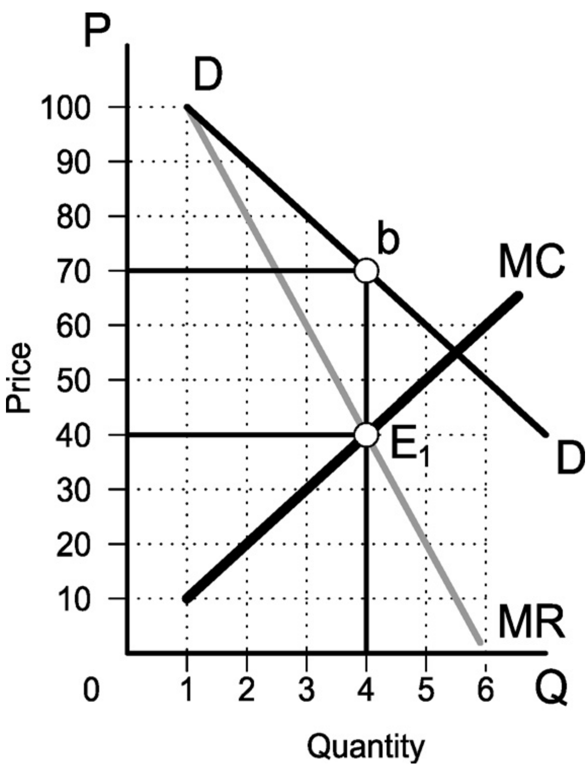
- There is only one seller of the good or service
- The good or service is unique and there are no close substitutes
- There are barriers to entry
- The monopolist is regarded as a price-maker (influences the market price)
- It is possible for the monopolist to make an economic profit in the long run
- It benefits from economies of scale
- Monopolist controls access to information.

Monopolies are therefore price-makers as opposed to perfect competition where the individual firm is a price-taker. Monopolies can determine the market price of a product. Therefore the marginal revenue and average revenue of the firm are no longer the same as the demand curve.

- The demand curve for the monopoly is also the market demand curve.
- The marginal revenue of a monopolist is lower than the demand curve.




**3. Determination of profit and loss in the short-term**




Profit maximisation position of a monopolist occurs at point $E_1$ where MC = MR.

**Short- run profits**
While the individual firm in a perfect competition is a price-taker, the monopolist is a price-maker. While the individual firm in a perfect competition is faced with a horizontal demand curve, the monopolist is faced with a downward-sloping demand curve. A firm in a perfect competition can sell any quantity at the market price, but the monopolist can reduce his price up to a point where he makes maximum revenue.
**Short-run losses**
It is possible for the monopolist to make a loss as well. The monopolist makes a loss if total cost (ATC) is more than average revenue (AR). Remember, AR is the price at which the product is selling. Now, if the cost is more than revenue, the company will make a loss.

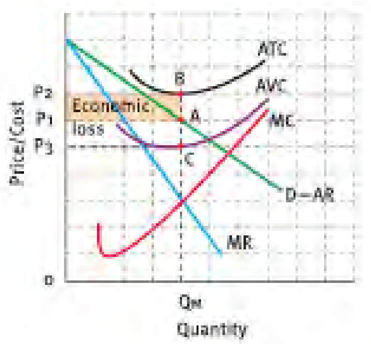



FIGURE 2.26 Short-run loss for the monopolist

**Long run profit** The monopolist makes economic profit even in the long term. Equilibrium in the long term is determined where LMR = LMC

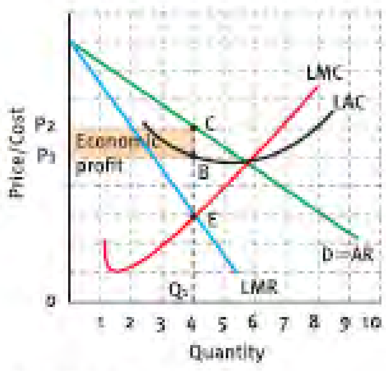



FIGURE 2.27 Long-run equilibrium of the monopoly

### 4. Comparison with perfect competition

- Demand curve: the individual firm in a perfect competition faces a perfectly elastic demand curve and therefore it cannot change the price. The monopolist faces a downward-sloping demand curve
- Efficiency: businesses in a perfect competition achieve both productive and allocative efficiencies. The monopolist produces smaller quantity than the perfect competition.
- Profit: the economic profit made in a perfect market decreases gradually as more firms enter the market. In the long term, a perfect competition produces normal profits. In a monopoly, economic profits are sustained indefinitely. The monopolist continues making economic profit both in the short-run and the long-run.

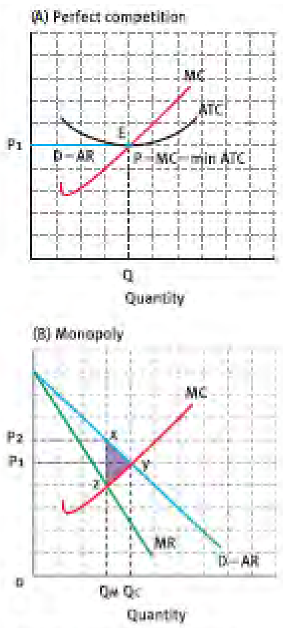



FIGURE 2.28 Inefficiency of monopoly compared against perfect competition

## Unit 3 Oligopolies

### 1. Description of oligopolies

An oligopoly is characterised by an industry dominated by a small number of large businesses. The businesses either sell identical products or differentiated products. There are also significant barriers to entry.

**2. Characteristics of oligopolies**

- Significant barriers to entry
- A number of businesses dominate the market
- The product may be identical or differentiated
- Interdependent decision making
- Limited number of businesses makes them price-fixers

**3. Non-price competition in an oligopoly**

Oligopolies prefer to use non-price competition to build customer loyalty. Examples include:

3.1 Advertising

They use advertising to gain a competitive edge over their competitors. The aims of advertising are to:

- provide information about the product
- persuade the consumer to make a purchase
- remind the consumer of the benefits of buying that particular product.

3.2 Branding

Branding is when a product or business is given a particular image which is appealing and attractive to its consumers.

3.3 Other forms of non-competition include:

- Free deliveries and installation
- Extended warranties for consumers and credit facilities
- Longer trading hours
- After-sales service
- Expansion into new markets through diversification of the product range.

**4. Collusion**

Collusion is a defining characteristic of oligopolistic industries. Intense competition and interdependent decision-making encourage oligopolistic firms to cooperate. This cooperation can be in the form of overt collusion or tacit collusion.

**5. Cartels**

Cartels are formed when businesses agree to fix prices or to limit supply. They can be unreliable because one firm can cheat on others and sell their product at a lower price to attract buyers. An example of a South African cartel is De Beers.

**6. Prices and production levels in an oligopoly**

It is difficult to draw the demand curve, marginal revenue curve and marginal cost curve for an oligopoly because the oligopolist must take into account the reactions of its rivals. It is impossible to quantify reactions and there are therefore many different models that are used to explain the demand curve of the oligopolist.

**7. Comparison with perfect competition**

- Prices are higher in an oligopoly
- The oligopoly produces a lower output
- An oligopoly enjoys higher profits.

# Unit 4 Monopolistic competition

**1. Description of monopolistic competition**

Monopolistic competition is more realistic than perfect competition or pure monopoly as it has the characteristics of both monopoly and perfect competition. The most distinguishing feature is that the products of various businesses are different, despite being close substitutes for each other. Products are therefore differentiated. Under monopolistic competition there is freedom to enter and to exit the market.

**2. Characteristics of monopolistic competition**

- Existence of a large number of businesses
- The products in monopolistic competition are differentiated, but relatively close substitutes for each other
- Has influence over the price
- Each firm acts more or less independently and can formulate their own price-output policy
- To promote sales, firms use non-price competition methods, such as advertising
- Freedom of entry and exit.

### 3. Non- price competition

Monopolistic businesses rely on quality, promotion, packaging, location or other factors to distinguish their product from competing brands rather than price. Examples include:

- Branding
- Advertising
- Packaging
- Service
- Information.

### 4. Prices and production levels

As with perfect competition, it is possible for the monopolistically competitive firm to make economic profit in the short-run.
Long-run equilibrium will be reached when only normal profits are earned and there is no further incentive for new firms to enter the market.

**5. Comparison with perfect competition**

Under monopolistic competition the price is higher, the average cost of production is higher and the level of output is lower therefore the individual firm under perfect competition is more efficient than the firm under monopolistic competition

## Questions

1. What are the main differences between allocative efficiency and technical efficiency? (4)

2. List four examples of non-price competition methods that an oligopolist may use. (8)

3. List seven characteristics of a monopoly? (14)

4. Explain the differences between a monopoly, oligopoly and monopolistic competition in terms of the following criteria:

a) Number of sellers

b) Nature of the product

c) Collusion between sellers

d) Restrictions on entry. (12)

5. Which of the following firms might be able to make an economic profit in the long run?

   a. Firm under perfect competition
   b. Monopolist
   c. Firm under oligopoly
   d. Firm under monopolistic competition

Give reasons for your choice. (4)

6. a. Draw a diagram to show the profit maximisation position of a monopolist. Identify the profit maximisation potion, the price and economic profits clearly. (6)

   b. Explain why a monopoly is regarded as inefficient. In your answer you should refer to the following:

- The monopolist as price maker
- The demand curve and the marginal revenue curve
- Its profit maximisation position
- Its average cost of production
- Price of the product
- Economic profits. (6)

# Topic 4 Dynamics of markets: market failures

## Overview

Market failures have consequences not only for individuals but for society as a whole.
In this topic, you will learn about:

- Causes of market failures
- Consequences of market failures
- Cost-benefit analysis.

Causes of market failures

- Imperfect market structures
- The existence of public goods and merit or demerit goods
- External costs and benefits
- Imperfect information
- Imperfect distribution of income and wealth
- Immobility of factors of production.

Consequences of market failures

- Public sector intervention:

- taxes and subsidies
- regulation of production or consumption of output.

Cost-benefit analysis

- **The advantages of cost-benefit analysis**
- **The disadvantages** of cost-benefit analysis
- Calculating private and social costs and benefits.

# Unit 1 The causes of market failures

**1. Introduction**

Market failures occur when the resources of the community are allocated inefficiently.

**2. Causes of market failures**

- Imperfect market structures

In the real world perfect market structures do not exist. Producers may be in a position to influence the price of the product due to the nature of the product and limited access to key natural resources. These barriers give producers some element of control over the price of the product. As a result of the barriers that limit entry to the market, various imperfect market structures developed in the form of monopolies, monopolistic competitors and oligopolies. Imperfect market structures lead to the inefficient allocation of resources.

- The existence of public goods and merit or demerit goods

Public goods are consumed by the community as a whole. It is impossible to exclude some consumers from using or consuming the product. As a result of this non-exclusivity, the private sector is usually unwilling to provide these public goods. Public goods therefore have to be provided by the government.

- The presence of external costs and benefits (positive and negative externalities)

Negative externalities are the costs that people incur from activities in which they have no direct involvement. For example, if a business pollutes the air, people living in surrounding areas may experience health problems and other adverse effects. The community will have an increased burden in the private costs of additional health care.

- Imperfect information (asymmetric information)

One of the conditions of perfect competition is that all buyers and sellers should have perfect knowledge of the market conditions so that they can make informed decisions. Households and firms should therefore have information on the quality, availability and prices of goods and services. However, in reality buyers and sellers experience a great deal of uncertainty and ignorance.

- Imperfect distribution of income and wealth

The free market system tends to generate an unequal distribution of income across the population. The income of consumers determines their access to consumer goods and services. The higher the income, the more goods and service a consumer can purchase and consume. This leads to an eventual improvement in the living standard of the population. When the government redistributes income from higher income groups to lower income groups, this will lead to a change in the consumption pattern of consumers.

- Immobility of factors of production

Markets may not respond to changes in consumer demand if resources cannot be easily reallocated. If the demand for one product decreases and the demand for another increases, it should be easy and quick to reallocated resources to satisfy demand. Most markets do not adjust quickly to changes in demand and supply.

## Unit 2 Consequences of market failures

1. Consequences of market failures

- The monopolist or oligopolistic business has some control over the price of the product and there are barriers that prevent new businesses from entering the market. This allows businesses to realise excess profits. The community therefore loses out on the benefits of more products and lower prices.

- Private producers are not willing to produce public goods and the government is forced to intervene and produce public goods.

- Some products are so complex that it is impossible for all consumers and producers to know everything about them. Some forms of imperfect information can be corrected by formulating simple rules such as the regulation against misleading advertisements. The government can also intervene and provide information to all members of society.

## Unit 3 Cost-benefit analysis

**1. The cost and decision criteria**

A cost-benefit analysis (CBA) is a method used to compare the total social costs and benefits of alternative projects, activities or investments. It is an accounting procedure used to compare the total cost of a project against its total benefits.

In deciding whether to proceed there are three possible criteria that are used to make the decision:

- Net present value (NPV): this reflects the present value of an investment project. If the net present value is positive it is worthwhile for the government to invest in the project.
- Internal rate of return (IRR): the interest rate at which the net present value of the project is zero (0). It is worthwhile to invest in a project if its internal rate of return is greater than the rate of interest.
- Benefit-cost ratio (BCR): the BCR for a project is the ratio between the sum of expected benefits and its costs.

**2. The rationale behind a cost-benefit analysis**

Allows for a measurement and comparison of all the costs and benefits of an economic activity. This determines the rate of return on a project and allows informed decisions to be made that are in the best interests of society.

**3. Price mechanisms**

An estimate must be made of the benefits of the project in monetary terms. Thereafter, the benefits are compared to the costs of providing the good or service. The private costs and benefits of the project will be reflected in the price of the project.

**4. Application**

In order to determine the cost-benefit ratio the following equation is used:
Cost-benefit ratio (CBR) = (Present value of economic benefits) ÷ (present value of economic costs).

**5. Uses of cost-benefit analysis in practice**

In South Africa, cost-benefit analyses are used often by government, government agencies and Non-Governmental Organisations (NGOs) to determine the costs and benefits of a variety of projects. Each department or organisation has developed a cost-benefit analysis document that serves as a guide for all of their future projects.

## Questions

1. What do you understand by the phrase cost-benefit analysis? (4)

2. What do you understand by the phrase market failure? (2)

3. Give two examples of collective goods and two examples of community goods. (8)

4. Explain the difference between private costs and social costs. (4)

5. Before allowing a new shopping centre to be built outside a town, the government will do a CBA. Answer the questions that follow, related to this project.
5.1 Describe the process that economists use to conduct a cost-benefit analysis. (10)
5.2 Give three items under social costs that will need to be measured. (6)
5.3 Give three items under social benefits that will need to be measured. (6)
5.4 Show the calculation used to calculate CBA. (4) (26)

6. Explain briefly the difference between merit and de-merit goods. (8)

7. List four ways that the government can deal with an unequal distribution of income. (8)

8. Write an essay explaining in detail the reasons for market failures. (40)

TERM 3

# Term 3
# Topic 1 Economic growth and development

## Overview

In this topic, you will learn about:

- The demand-side approach to economic growth
- The supply-side approach to economic growth
- Evaluation of the approaches used in South Africa
- The North/South divide.

Demand -side approach

- Increased government expenditure
- Redistribution of income to encourage consumption
- Import substitution
- Export promotion

Supply-side approach

- Improved quality of the labour force.
- Managing and using natural resources.
- Accumulating capital goods
- Advancements in technology
- Entrepreneurs identify opportunities and combine with the other factors of production

Approaches used in South Africa

- Reconstruction and Development Programme (RDP)
- Growth, Employment and Redistribution
- Accelerated and Shared Growth initiative of South Africa (Asgi-SA)
- New Growth Path (NGP)

The North/South Divide

- The economic divide
- The human divide

## Introduction

This unit studies the methods used by governments to encourage economic growth and development . You will also look at the approaches used in South Africa and discuss the problems of the North/South divide and income inequality. BY the end of the unit you should be able to discuss critically the difference between economic growth and development and also be aware the difficulty in creating sustainable ways of income redistribution.

# Unit 1 The demand-side approach

## 1. The meaning of demand-side approach

- The demand-side approach emphasises the fact that for a country to have economic growth, there is a need to increase aggregate demand.
- Aggregate demand consists of the total spending on domestic goods and services.
- By making discretionary changes to monetary and fiscal policies the government can encourage an increase in total spending,

Aggregate demand (GDP) in the economy consists of consumption demand (C), investment demand (I), government demand (G) and net exports (X – M).

Changes in GDP (total spending) can be expressed as the following formula:

Change in GDP = (change C) + (change I) + (change G) + (change (X – M))
$\Delta GDP = \Delta C + \Delta I + \Delta G + \Delta(X - M)$

Policies which encourage economic growth by stimulating aggregate demand are often called Keynesian policies.

According to the demand side approach, the economy can be stimulated by:
- Increased government expenditure
- Redistribution of income to encourage consumption
- Import substitution
- Export promotion

## 2. Factors that influence development strategies

The main aim of development strategies is to reduce poverty, inequality and unemployment which will lead to a rise in standards of living. An increase in demand for domestic goods and services will cause an increase in production levels and output provided that there are sufficient factors of production to manufacture the goods and services.

The following factors can influence development strategies:

- Consumer spending will increase if there is an increase in disposable income. Disposable income will increase if there is an increase in production.
- Investment spending involves spending on capital goods such as machinery, tools and factory buildings with the aim of producing more goods and services. The provision of more capital goods leads to the employment of more workers who in turn earn income which leads to an increase in the demand for goods and services.
- Government spending creates employment and provides important infrastructure and amenities.
- An increase in exports increases the growth rate because they create a bigger demand for domestic products and services .

- South Africa imports capital and intermediate goods to use in the production of goods and services.

# Unit 2 The supply-side approach

### 2.1. Meaning of the supply-side approach

The supply-side approach is an ***economic theory*** that encouraging the economy's ability to ***supply*** more goods is the most effective way to stimulate economic growth. This can only be achieved if there are quality factors of production (natural resources, labour, capital and entrepreneurial skills).

**Approaches**

The following strategies will help increase the following production factors:

- Improving the quality of the labour force by training and education, developing work ethic and work attitudes.
- Managing and using natural resources in a responsible manner.
- Accumulating and building up capital goods
- Advancement in technology stimulates economic growth and development and is important because amongst other things it helps the country to produce a wider variety of goods and improve the quality of goods and services produced.
- Entrepreneurs are very important to the development of a country. They identify opportunities and combine them with other factors of production to produce goods and services.

# Unit 3 Evaluation of the approaches used in South Africa

The South African approach to economic development and growth includes both transformation of the economy for reconstruction and development as well as growth, employment and redistribution.

### 3.1 Approaches used in South Africa

The following policies outline South Africa's plans for economic growth:

**Reconstruction and Development Programme (RDP)**
This policy was introduced in 1994 as the main development strategy. It has five major policy programmes:

- To meet basic needs

- To develop the country's human resources
- To build the economy
- To democratise the state and society
- To implement the Reconstruction and Development Program (RDP).

**Growth, Employment and Redistribution**
This policy was launched in June 1996 as a macro-economic strategy for South Africa. It incorporated the priority for economic growth, employment and redistribution of income and emphasised the need for market led growth, fiscal and monetary discipline and increasing investor confidence.

**Accelerated and Shared Growth initiative of South Africa (Asgi-SA)**
Asgi-SA was introduced in February 2006 with the objective of halving unemployment and poverty by 2014. To achieve this, it aimed to increase average economic growth.

**New Growth Path (NGP)**
The New Growth Path was introduced in 2010 to accelerate growth and employment. It focused on job-creation and sector-based actions that would help to achieve this. The NGP identified the following job drivers:

- Public investment in infrastructure to create direct employment in the construction, operation, maintenance and production of projects. This will also indirectly improve efficiency across the economy.
- Development of more labour-absorbing activities in the agricultural and mining value chains, especially in manufacturing, construction and services.
- Investment in innovation and research for the development of a 'green economy'.
- Support for rural development and regional integration.

## 3.2. Evaluation of SA's development policies

**Social policies**
South Africans want a faster pace of development and whilst much has been achieved since 1994 to provide public services, the challenges of poverty and inequality remain. The government has developed a number of interventions to address continuing social issues. These include:

- Social grants paid to various groups in society
- Providing toilets and improved waste management
- Increasing the number of home-owners
- Providing greater access to education.

**Macro-economic policies**
A well-structured macro-economic policy helps society to develop and have growth for a number of years. It should address broad issues such as ownership, competition, foreign investment, interest rates and exchange controls. The macro-economic policy should be stable and offer investors security and predictability.

**Micro-economic policies**
Unemployment remains the greatest economic and social challenge in South Africa. The government can address this issue through focused microeconomic policies that target industries that have the most potential to create jobs.

**Black Economic Empowerment**
As part of economic and social development, the government aims to create economic opportunities for black South Africans who were previously excluded from economic activity.

**Land redistribution and restitution**
The government is addressing the question of land ownership in South Africa. The government uses such mechanisms as the Land Bank and the Land Redistribution Act to return land to historical owners.

**Affirmative action**
The South African labour market still contains disparity in access to and quality of employment due to previous Apartheid education and labour policies. The ANC government has been addressing through job creation programmes, progressive legislation and legal reform. The Employment Equity Act (1998) obliges employers to implement affirmative action measures to ensure equal representation of designated groups (black people, women and people with disabilities).

### 3.3 Evaluation of SA's growth

- In April 2010, the World Bank classified South Africa as: upper middle income at rating 3 with GDP per capita ranging from $3 856 to $11 905.
- In the period 2006 to 2011, the labour participation ratio averaged 52% and the unemployment rate averaged 22%.
- Between 2007 and 2009, South Africa's level of inflation was too high for strong growth. In 2010 and 2011, however, it decreased to within the SARB's target range of 3–6%.

# Unit 4 The North/South divide

### 4.1. Description of the North/South divide

The North/South divide is a socio-economic and political division that exists between the wealthy developed countries, known collectively as "the North" and the poorer developing countries, known as "the South". Although most nations comprising the "North" are in fact located in the Northern Hemisphere (with the notable exceptions of Australia and New Zealand), the divide is not wholly defined by geography. The North is home to four of the five permanent members of the United Nations Security Council and all members of the G8. "The North" mostly covers the West and the First World, along with much of the Second World. The expression "north–south divide" is still in common use, but the terms "North" and "South" are already somewhat outdated. As nations become economically developed, they may become part of the "North", regardless of geographical location, while any other nations which do not qualify for "developed" status are in effect deemed to be part of the "South.

### 4.2. Economic divide

Income levels are higher in the North which suggests that they add greater value to earn higher income. Higher incomes mean more money to spend which in turn leads to more development. The government can also raise more taxes and provide better services and public goods to improve the general standard of living.

### 4.3. Human divide

The United Nations Human Development Index (HDI) helps to classify human development and living conditions. It emphasises the unequal standard of living throughout the world. It measures three basic dimensions of human development: health, education and income.

## Questions

1. Explain what is meant by the term demand-side approach . (8)

2. List five strategies that will help to increase production factors. (10)

3. Explain what is meant by the term the North/South divide. (8)

4. What does the abbreviation HDI stand for? (2)

5. Provide an brief overview of growth and development strategies that had been implemented in South Africa since democratisation. (40)

6. Critically discuss the New Growth Plan. (8)

7. Discuss the issues that AsgiSA failed to address and explain why these are important. (8)

8. Explain each of the following indicators: (15)
(a) percentage annual change in gross domestic product at market prices
(b) percentage annual change in gross domestic product at constant 2005 prices
(c) gross domestic product per capita at constant 2005 prices
(d) income distribution
(e) human development index

# Topic 2 Economic growth and development: industrial development policies

## Overview

In this topic, you will learn about:

- Industrial development
- Regional development
- South Africa's endeavours
- The appropriateness of South African strategies.

Industrial development

- The pre-1994 industrial policy
- Industrial development policy after 1994
- The National Industrial Policy Framework (NIPF)
- The Industrial Policy Action Plan (IPAP)

Regional development

- Spatial development initiatives (SDI)
- Industrial Development Zones (IDZ)
- The Special Economic Zones (SEZs)

The conditions for industrialisation

- A stable and supportive macroeconomic and regulatory environment
- Skills and education for industrialisation
- Traditional and modern infrastructure
- Innovation and technology.

South African strategies -areas to strengthen

- Industrial financing policy
- Sectors need to be expanded and policies developed
- Competition policy must be reviewed and strengthened
- The role of big and larger medium-sized firms
- Import substitution and export promotion strategies
- Government intervention.

South African strategies -successes

- Motor Industrial Development Programme
- Industrial Development Corporation (IDC)
- Technology programmes

# Unit 1 Industrial development

## 1. South Africa's industrial development policies

South Africa has experienced a major shift in industrial policy since 1994 away from an inward-looking industrial policy towards an outward-looking industrial policy.

### 1.1 The pre-1994 industrial policy

In the early 1990s South Africa faced an economic crisis. Gross Domestic Product and investment rates were falling. The export growth of goods and services was unpredictable and focused on mining and mineral products. During this period, the government imposed inward looking economic policies including protectionist policies aimed at limiting the impact and damage caused by sanctions. The economy was characterised by vast inequality and many groups of people were excluded from the economy.

### 1.2 Industrial development policy after 1994

After the first democratic elections in 1994, the government abandoned the inward looking policies of the past and adopted more outward-looking economic policies. Tariffs were cut substantially, and local businesses faced increasing exposure to foreign competition and the forces of globalisation.

The South African economy has achieved steady growth since 1994. It has also experienced important diversification away from the apartheid-era minerals-linked growth path. A range of sectors have experienced good growth, for example the tourism, automotive and wine industries.

### 1.3 The National Industrial Policy Framework (NIPF)

The primary objective of the NIPF is to set out government's approach to the industrial development of the South African economy. Consequently the NIPF sets out a vision for the industrial economy for both the short-medium and medium-long term.

The NIPF has had an important role to play in achieving the Accelerated and Shared Growth Initiative of South Africa's (ASGI-SA) goals of accelerating GDP growth and halving unemployment and poverty by 2014. This includes the further intensification of industrialisation towards a knowledge economy beyond 2014.

### 1.4 The Industrial Policy Action Plan (IPAP)

The Industrial Policy Action Plan (IPAP) sets out in detail key actions and time frames for the implementation of industrial policy. It has three main components:

- A range of sectoral actions
- A set of cross-cutting actions of particular importance for industrial policy
- Measures to improve government’s organisation and capacity to implement industrial policy.

The action plan aims to promote long-term industrialisation and diversification beyond traditional commodities and non-tradable services, by expanding production in value-added sectors with high employment and growth opportunities.

Emphasis is placed on labour absorbing production and services sectors, increasing access to the economy of historically disadvantaged people and regions, and building South Africa's contribution to industrial development beyond our borders.

### 2. Necessary conditions for industrialisation

For an industrial economy to function properly and for industrial policy to be successful, a range of policies and institutions must be aligned and coordinate their activities. These include the following:

- A stable and supportive macroeconomic and regulatory environment
- Skills and education for industrialisation
- Traditional and modern infrastructure
- Innovation and technology.

# Unit 2 Regional development

### 2.1. Rationale for regional development

Regional development is a multidisciplinary process that includes all aspects of human development, economic development and physical development in specific geographical areas, called regions. The aim of regional development is to achieve the best possible distribution of economic activities. In order for regional development to be successful  South Africa needs to have strong partnerships with other countries. To this end South Africa has entered into several agreements with other countries.

### 2.2. Best practice principles

The following best practice guidelines should be used for successful regional development:

- Total development as a multidimensional process
- Development of people, for people, by people
- Developments should start from within the region
- It must concentrate on basic issues where the most urgent human needs exist
- Cooperation between the private and public sectors and the local community.

### 2.3 South Africa's regional development policy

South Africa's regional development policy includes the following initiatives: Spatial Development Initiatives (SDIs), Industrial Development Zones (IDZs),Special Economic Zones (SEZs) and Financial Incentives.

# Unit 3 South Africa's endeavours

## 3.1. Spatial development initiatives (SDI)

**Meaning**

The Spatial Development Initiative (SDI) methodology was developed in South Africa in 1996 as an integrated planning tool aimed at promoting investment in regions of the country that were underdeveloped but had potential for growth. The methodology involves a process in which the public sector develops or facilitates conditions conducive to private sector investment and Public-Private-Community Partnerships.

SDI's will extend beyond the borders of South Africa when the economic objectives can only be achieved if parts of a neighbouring country are included. Examples are the Maputo Development Corridor between South Africa and Mozambique (also including Swaziland, Zimbabwe and Botswana), and the Lubombo Initiative between South Africa, Mozambique and Swaziland. Economic integration in Southern Africa allows the region to use economic policies collectively, which has the potential to achieve greater developmental benefits for all.

**Industrial Development Zones (IDZ**)

Industrial Development Zones are designed to boost exports and jobs. Each zone is regulated and administered by a National Development Zone Authority (NDZA). The plan is that every IDZ will eventually have its own local NDZA to carry out the regulatory and approval process. The private sector develops and manages industrial zones. Examples of IDZs are explained below:

The Coega IDZ

The Coega Industrial Development Zone (IDZ) covering 110 km$^2$ of land is situated near Port Elizabeth, in the Eastern Cape. The initiative is a multibillion-dollar industrial development complex customized for heavy, medium and light industries, adjacent to a deepwater port, Port of Ngqura. The Coega Development Corporation (CDC) is the developer and operator of the Coega IDZ and is responsible for the land side infrastructure, while the deep-water port facility, Port of Ngqura, is developed by the Transnet National Ports Authority.

The East London IDZ

This IDZ was designated in 2002 and is located in the Buffalo City Municipality in East London. The Eastern Cape Development Corporation owns 76% of the zone and the Buffalo municipality owns the remaining 24%. The key sectors within the zone are automotive, marine aquaculture, agro-processing of bio fuels, food, timber processing, pharmaceuticals, ICT, electronics and business process outsourcing.

The Richards Bay IDZ

This IDZ was designated in 2002 and is located in Richards Bay. It is an agency of the Provincial Department of Economic Development and Tourism. It was established to attract investment in export-oriented manufacturing, to improve productivity, to manufacture import replacements and to develop exports.

**The Special Economic Zones (SEZs)**

A Special Economic Zone (SEZ) is a geographical area of the country set aside for specifically targeted economic activities. These activities are supported through special arrangements that may include laws and support systems that promote industrial development.

# Unit 4 **The appropriateness of South African strategies**

## 4.1. Reflections on South Africa's industrial development policies

South Africa's industrial and trade policies have enjoyed many successes. Examples include:

Motor Industrial Development Programme

This programme contains a requirement that locally assembled vehicles must contain a minimum quantity of locally manufactured content. This measure helped preserve employment and ensured the survival of our automotive industry.

Industrial Development Corporation (IDC)

The IDC has contributed to the restructuring of those sectors which experienced difficulties in the early 1990s. The IDC's investment patterns have shifted to support more labour intensive sectors and BEE objectives. IDC investments in BEE expansion projects have been the biggest creators of employment. This demonstrates the importance of broad-based activity in the economy for industrial development.

Technology programmes

The South African government has introduced programmes that help businesses develop and implement new technologies. These programmes have been highly successful . Examples include: Support Programmes for Industrial Innovation (SPI) and the Technology and Human Resources for Industrial Programme (THRIP).

## 4. 2. Areas that need to be strengthened

Despite South Africa's successes in industrial development the economic environment continues to change and the following areas need to be strengthened:

- Industrial financing policy
- Sectors need to be expanded and policies developed to encourage closer sectoral collaborations
- Competition policy must be constantly reviewed and strengthened

- The role of big and larger medium-sized firms
- Import substitution and export promotion strategies
- Government intervention.

## Questions

1. List three components of the Industrial Policy Action Plan (IPAP). (6)

2. List the best practice guidelines should be used for successful regional development? (10)

3. Give two examples of IDZs in South Africa? (4)

4. Describe the function of the IDC? (4)

5. Define the following concepts:
   - The Industrial Development Corporation (IDC)
   - Spatial Development Initiatives (SDIs)
   - Industrial Development Zones (IDZ)
   - Development corridor
   - Integrated Sustainable Rural Development Programme (ISRDP) (20)

6. Explain why a spatial development initiative that involves more than one country may be beneficial to all countries involved. (5)

7. Briefly discuss the following aspects that should be addressed in an Industrial development policy:
   - Identification of sectors earmarked for development
   - Small business development
   - Black Economic Empowerment
   - Involvement with larger region
   - Labour practices (15)

8. Why is it important that the private sector should be involved in an industrial or regional development policy plan? (6)

# Topic 3 Economics: basic concepts and quantitative elements (economic and social performance indicators)

## Overview

This topic describes the most important concepts and indicators that are used to measure economic growth and development. It is important that you understand them and can interpret them.

In this topic, you will learn about:

- The performance of an economy
- Economic indicators
- Social indicators
- International comparisons.

Economic Indicators

- Consumer Price Index
- Production Price Index
- Balance of Payments
- Employment rate
- Interest rates
- Money supply

Social Indicators

- Human Development Index
- Health and nutrition
- Education
- Services

International comparisons

- Globalisation
- International organisations

## Unit 1 **The performance of an economy**

### 1. Assessing the performance of the economy

The South African Reserve Bank and Statistics South Africa provide the data that government uses to assess economic performance. This information is important as it helps the government, private sector and international investors must know how the economy of a country is performing.

## Unit 2 **Economic indicators**

### 1. Meaning

An economic indicator is a statistic (data) that shows the behaviour of an economic variable over a specific period of time and are used to measure the performance of the economy.

### 2. Inflation rate

- Inflation is a rise in the general level of prices of goods and services in an economy over a period of time.
- The inflation rate is monitored at both producer and consumer levels.
- The indicator at producer level is called the Production Price Index PPPI) and at consumer level it is called the Consumer Price Index (CPI).

**Calculating the inflation rate:**

```
CPI year 2 – CPI year 1/CPI Year 1 ·100/1
= CPI year 2 – CPI year 1
CPI year 1 × 100
```

The South African Reserve Bank introduced inflation targeting which is a new approach to monetary policy and price stabilisation. The target range for inflation is 3–6%, and if it moves outside this range the SARB uses monetary policy  to try to bring the rate back within the target range.

### 3. Foreign trade

It is important for South Africa to keep a favourable ratio between exports and imports to avoid a deficit in the balance of payments. It is also important to monitor the volatility of exchange rates.

### 4. Employment

The labour force comprises all people between the ages of 15 and 65 years. It  is important to calculate the employment rate which reflects the percentage of this group that have decent employment. A low employment rate results in low productivity and a low growth rate as well as economic hardship for those who are unemployed.

### 5. Productivity

Productivity is the ratio between goods and services produced in the economy and the input of resources used to produce them.

Productivity = output/factor input = output per unit of factor input

Three forms of productivity can be calculated: labour, capital and multi-factor productivity.

### 6. Interest rates

An ***interest rate*** is the rate at which interest is paid by borrowers for the use of money that they borrow, usually from a financial institution such as a bank. In South Africa, interest rate decisions are taken by the South African Reserve Bank's Monetary Policy Committee (MPC). The official interest rate is the repo rate, which is the rate at which the central bank lends or discounts money to commercial banks.

### 7. Money supply

The level of money supply in the economy is very important because any change in its quantity will have a direct effect on interest rates. A decline in money supply will lead to a shortage of money and cause an increase in the interest rate. An increase in the supply of money without an increase in supply of goods and services will lead to increase in prices which will lead to inflation in the long-run.

## Unit 3 **Social indicators**

### 1. Meaning

Social indicators are sometimes called human development indicators or development indicators because they indicate changes the standard of living.

### 2. Demographics

Demographics provide information about where people are located, what their needs are and how investment can be best spent.

**2.1 The Human Development Index**

The HDI attempts to define human well-being more broadly. It provides a combined measure of three basic dimensions of human development: health, education and income.

### 3. Health and nutrition

The government spends about 8,3% of GDP on health services. The infant mortality rate for 2011 was estimated at 37,9. This is a high rate and improvements must be made in this area of healthcare. The estimated overall HIV prevalence rate is approximately 10,6%. Although this rate is declining it is still unacceptably high and more work and investment needs to be made to lower it.

### 4. Education

A high ratio of literacy, knowledge and skills can be achieved through effective and appropriate education and training. The South African government spends 20% of total state expenditure on education. When a large percentage of the population is well-educated, the economy will be more productive and competitive which then creates national wealth and a higher standard of living per capita.

### 5. Services

It is the responsibility of the government to provide certain services. It is the responsibility of Stats SA to collect information to measure the level of development and performance of various government programmes and projects. These services are:

- Energy
- Sanitation, refuse removal and water access and use
- Access to food
- Housing and urbanisation.

# Unit 4 **International comparisons**

### 4.1. Introduction

Since 1994 South Africa has undergone vast social and economic changes. The government has introduced important reforms throughout the whole economy. The international comparisons for South Africa can be traced through the following identified below.

### 4.2. Globalisation

Globalisation is the process of international integration through the interchange of world views, products, ideas, and other aspects of culture.
Since 1994 South Africa has become increasingly more involved in world markets through exports and imports.

### 4.3. International comparisons

South Africa is able to monitor the progress of its economic and social development by comparing its performance with that of other countries through data collected by international organisations These organisations include:

- The United Nations
- The World Bank
- The International Monetary Fund.

## Questions

1. Why are international comparisons of economic and social indicators important? (4)
2. Explain the importance of the human development index as an economic indicator. (6)

3. Explain how each of the following indicators is measured and why they are important:
   (i) inflation rate (14)
   (ii) unemployment rate (10)
   (iii) interest rates (27)
   (iv) money supply (15)

4. Name three uses of economic indicators. (6)
5. Name and briefly describe the different methods and tools that economists can use to make forecasts of the economy. (16)
6. Explain why each of the following indicators are important in a developing economy:
   (i) net merchandise exports (2)
   (ii) balance on the current account of the balance of payments (4)
   (iii) balance on the financial account of the balance of payments (4)

7. Explain why the unemployment rate is a lagging indicator. (2)

# Topic 4 Economic issues of the day: inflation

## Overview

This topic discusses the meaning and significance of inflation, types of inflations, its causes and measures used to control and combat the problems caused by inflation.

In this topic, you will learn about:

- Inflation
- Types and characteristics of inflation
- Causes and consequences of inflation
- The inflation problem in South Africa
- Measures to combat inflation.

Types and characteristics of Inflation

- Demand-pull inflation
- Cost-push inflation
- Consumer inflation
- Producer inflation
- All-inclusive inflation
- Hyperinflation
- Stagflation
- Deflation

Causes and consequences of inflation

- Causes of demand-pull inflation
- Causes of cost-push inflation
- Increase in money supply
  Consequences of inflation

Inflation in South Africa

- Historical perspective
- Measurement of inflation in South Africa
- Consumer inflation

Measures to combat inflation

- Fiscal measures
- Monetary measures
- Other measures

# Unit 1 **Inflation**

**1. 1. Definition of inflation**

inflation is a rise in the general level of prices 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.

It is important to remember the following points about inflation:

- Inflation refers to a rise in prices in general

- It reduces the purchasing power of money
- It is a process that takes place over a period of time
- It refers to a significant increase in price.

Make sure that you refer to the charts and tables in your learner book when studying this section.

# Unit 2 **Types and characteristics of inflation**

### 2. 1. Demand pull-inflation

A rise in the price of a product or service is normally caused by a shortage of supply and an increase in demand. Demand-pull inflation usually occurs when the aggregate demand for goods and services increases, without an increase in aggregate supply.

Demand-pull inflation has the following characteristics:

- A relative increase in total demand.
- Foreigners contribute to demand-pull inflation because they demand imported goods and this demand puts greater strain on limited supply and increases prices further.
- All participants in the economy contribute to demand-pull inflation because they all buy goods that increase the demand-side of the market.
- If the demand for goods and services rises more rapidly than supply, a shortage will arise and prices will rise to match demand causing inflation .

### 2. 2. Cost-push inflation

Cost-push inflation happens when there is an increase in the costs of production which results in a general increase in price.

Cost-push inflation has the following characteristics:

- An increase in total costs on the supply-side of the market.
- An increase in labour costs is added to the cost of production and therefore causes cost-push inflation.
- When producers increase their profit margins, they increase the purchase price of their products and this leads to cost-push inflation.
- An increase in taxes such as value-added tax (VAT), would lead to cost-push inflation.
- More expensive imported products, especially intermediate goods, add to the price of finished products on the supply-side and this adds to cost push inflation.
- Natural disasters can increase the costs of production.
- Lower productivity can also increase the costs of production.

### 2. 3. Consumer inflation

In South Africa the following types of consumer inflation are identified:

- Headline inflation
- CPIX inflation
- Core inflation
- Administered prices inflation.

### 2.4. Producer inflation

We use the Production Price Index (PPI) to measure producer inflation. The PPI measures prices at the level of first significant commercial transaction. For instance the moment imported goods enter the country or the moment goods leave the factory where they were made.

### 5. All-inclusive inflation

The GDP deflator is used to calculate all-inclusive inflation ( all goods and sevrices)and to give an inflation rate for the economy as a whole.

### 6. Hyperinflation

Hyperinflation is a very rapid increase in price levels at a really high inflation rate which causes money to become worthless.

### 7. Stagflation

Stagflation is a condition where there is low economic growth, a high unemployment rate and high rates of inflation.

### 8. Deflation

Deflation is a decrease in the general level of prices in the economy.

---

## Unit 3 **Causes and consequences of inflation**

### 3. 1. Introduction

There are many different theories about what causes inflation and how best to deal with it.

### 3.2. Causes of demand-pull inflation

As discussed in the previous unit demand-pull inflation can be caused by an increase in any of the components of aggregate demand: consumption spending, investment spending, government spending or exports.

The following factors can lead to demand-pull inflation:

**Increase in consumption (C)**

The increase in consumption may be caused by any of the following:

- Easy access to credit
- Lack of savings
- Reduction in taxes.

**Investment spending**

A reduction in interest rates will encourage firms to expanding their operations. When they do this, they increase the supply of goods and this may lead to an increase in the demand for goods and services. If aggregate demand increase at a faster rate than aggregate supply, prices will increase further.

**Government spending (G)**

An increase in government spending without an increase in productivity will lead to inflation. The government can increase its spending through the following ways:

- Social grants
- Infrastructure
- Consumption spending.

**Export earnings**

An increase in exports without an increase in local production will cause inflation because goods and services leave the country and reduce the volume of goods available locally.

### 3.3. Causes of cost-push inflation

The following factors may cause cost-push inflation:

- Workers demanding higher wages with no increase in their productivity.
- A drop in productivity while employment and wages remain constant.
- Strikes and other labour actions that reduce production output and cause a drop in the supply.
- An increase indirect and indirect taxes.
- An increase in import prices.
- An increase in administered prices may result higher wages.
- An increase in a producer's profit margin may be added to the selling price and contribute to inflation.
- An increase in interest rates.

### 3.4. An increase in money supply

An increase in the quantity of money in circulation without an increase in the supply of goods and services can also lead to inflation.

### 3.5. Consequences of inflation

Inflation can have very harmful effects on the economy:

- Inflation affects the distribution of income and wealth
- Inflation leads to a decline in the real value of saving
- Inflation decreases the buying power of money
- Inflation affects certain groups at the expense of others
- Inflation has an adverse effect on a country's balance of payments
- Inflation impacts negatively on economic growth
- A high rate of inflation is harmful to the workings of a system of free enterprise.

# Unit 4 The inflation problem in South Africa

## 4.1. Historical perspective

The 1980s in South Africa were characterised by political unrest, economic turmoil and international sanctions. Many companies were forced to leave and there was very little international investment in South Africa. This resulted in a sharp increase in inflation because demand exceeded supply and import substitution was prevalent. During this period inflation rose 18,6%, peaking in 1986.

The periods between 1994 and 2005 were characterised by a return to a relatively low inflation rate. In 2000, the Minister of Finance announced that the South African government was introducing inflation targeting and had set a target of 3–6%.

The period 2007 to 2009, the inflation rate increased remarkably and exceeded the target. From 2010, the inflation rate has seen gradual and moderate increases and decreases.

## 4. 2. Measurement of inflation in South Africa

**Consumer Price Index (CPI)**

CPI is the most commonly used measure of inflation in South Africa and is compiled by Statistics South Africa.

**Relative method (Weightings basis)**

This method assigns weightings to each item selected in order to reflect its relative importance in the index.

**Month-on-month comparison**

The most common practice in South Africa is to compare the index for a particular month with the index of a corresponding month during the previous year.

**Annual average on annual average**

When inflation has to be calculated for a calendar year, the procedure is to compare the average of all indices in a particular year with the corresponding average for the previous year.

**Consumer inflation**

Consumer inflation means a rise in the prices of goods and services bought by consumers rather than producers, for example foodstuffs and clothing.

---

# Unit 5 Measures to combat inflation

## 5.1. Fiscal measures

The following steps can be taken to control inflation:

**Raising taxation**

Increasing taxation can help curb excess demand in the economy.

- Direct taxation will leave consumers and businesses with less money to spend.
- Indirect taxation will lead to an increase in the cost of living and will reduce demand because consumers will buy fewer goods and services.
- Levies on loans can be introduced or increased.
- A surcharge on imports can be levied increasing the cost of imports and decrease demand.

**Reducing government spending**

If the level of inflation is high, the government can reduce its own spending on public goods and services.

**Implementing supply-side economic policies**

The government can implement policies that will increase productivity, competition and innovation. Such policies will maintain lower prices. These policies are aimed at stimulating supply and may include:

- Lower taxes on personal income to encourage people to work harder.
- Lower taxes for companies to encourage investment and capital formation.
- Lower taxes on interest and dividends to encourage greater savings.
- A reduction in government savings.

## 5.2. Monetary measures

The South African Reserve Bank can take the following steps to combat inflation:

- Increase repo rate
- Adjust the quantity of money to the needs of the economy
- Decrease money supply

- Restrict the granting of credit by banks
- Reduce currency control.

### 5.3. Other measures

Other measures may need to be implemented in combination with fiscal and monetary measures to successfully combat inflation such as:

- Increasing productivity
- Price control
- Stricter conditions for consumer credit
- Relaxation of import controls
- A floating exchange rate for the country's monetary unit
- Applying the principle of indexation
- Introduce a wage policy that only allows for an increase if there is an increase in productivity.

**Inflation targeting policy**

South Africa formally introduced inflation targeting in February 2000.Inflation targeting is a monetary policy that works as follows: the central bank announces a clear inflation target and then implements appropriate policy to achieve this target. Inflation-targeting creates a more transparent monetary policy because policies can be understood in relation to the target. This also allows for greater transparency encouraging investment.

## Questions

1. Describe the relationship between inflation and purchasing power. (4)
2. Name three causes of demand-pull inflation? (6)
3. Name three causes of cost-push inflation. (6)
4. Name three possible measures that can be used to fight demand-pull inflation. (6)
5. Name three measure that can be used to fight cost-push inflation. (6)
6. Describe the economic effects of inflation. (12)
7. Indicate whether the following statements are true or false. Give a reason for your answer.

a. Inflation benefits those who receive fixed money incomes. (2)
b. The purchasing power decreases if inflation increases. (2)
c. An increase in input cost can cause demand-pull inflation. (2)
d. If the rand depreciates, the rate of inflation will decrease. (2)
e. Higher income taxes will reduce excessive demand in the economy. (2)
f. Reducing government spending is a monetary measure to curb inflation. (2)

(12 marks)

# Topic 5 Tourism and economic redress: environmental sustainability

## Overview

This topic discusses tourism as an important part of the South African economy, the reasons for its growth and the benefits of this increased growth.

In this topic, you will learn about:

- Reasons for the growth of tourism
- The effects of tourism
- The benefits of tourism
- South Africa's profile (indigenous knowledge systems)
- Policy suggestions.

Reasons for the growth of tourism

- Increased access to airspace in SA
- Targeted as an industry by government
- Increased disposable income
- Importance of leisure
- More efficient transport and communication

The effects of tourism

- Employment
- Poverty alleviation
- Externalities
- Infrastructure
- Human and environmental costs

Benefits of tourism

- To households
- To businesses
- To the Government

South Africa's profile

- Indigenous Knowledge systems

Policy suggestions

- The National Tourism Sector Strategy (NTSS)
- The marketing strategy
- Directing the spatial distribution of tourism
- The role of infrastructure

# Unit 1 Reasons for the growth of tourism

## 1. 1. The important role of tourism

Tourism has been identified as a key economic sector with excellent potential for growth. The National Department of Tourism (NDT) is responsible for creating the conditions for the growth and development of tourism, and for marketing South African tourism internationally.

The United Nations World Tourism Organisation (UNWTO) defines tourists as people "travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes".

When activities take place in a certain area which attracts visitors to that area who might otherwise not visit it, it creates income for that area.

South Africa's growth in tourism was double that of the world average in 2010. This growth has been rapid and sustained over a period of years. Tourism brings with it foreign currency and this provides the country with foreign exchange. Tourists also demand local goods which increase demand and productivity.

### Reasons for the growth of tourism

- The South African government has approved more access to airspace for commercial airlines. This has resulted in an increasing number of international airlines flying to South Africa.
- Governments of all developing countries have targeted the tourism sector as an industry with huge potential..
- An increase in disposable income provides more households with the means to travel boosting domestic tourism.
- An increase of the importance of leisure means that people are spending more time travelling.
- More efficient transport and communication systems makes travelling more convenient.

### Domestic tourism growth

Domestic tourism is the movement of people within their own country. Domestic tourism is extremely important to the growth of the tourism industry. It makes the industry sustainable and drives its growth and development. Domestic tourism can also withstand global uncertainty and sustain the industry during periods of international recession.

In order to ensure the continued growth of the domestic tourism industry, the South African government:

- Promotes domestic-tourism.
- Promotes a set of South African experiences to which South African consumers can relate.
- Distributes appropriate information about destinations and opportunities in specific and relevant places.
- Facilitates the development of cooperative travel product packages that make travel cheaper and more accessible.
- Develops marketing and distribution channels for SA tourism.
- Promotes repeat visitation.

**Foreign tourism**

Foreign tourism is the movement of people between countries; these people are referred to as international tourists. Foreign tourists can be classified as being either Inbound international tourists or Outbound international tourists.
The increase in foreign tourists are important for South Africa because they:

- Increase employment opportunities in the tourism sector
- Bring in foreign exchange into the country
- Improve international perceptions of South Africa.

## Unit 2 The effects of tourism

Tourism generates income. If the tourists enjoyed the area and come back and through word of mouth encourage other people to visit the area this has a long term effect of attracting more tourists and generating more income.

**Employment**

Tourism not only generates revenue to support conservation and management of natural environments, but it also generates jobs because it is labour intensive and has few barriers to entry. Directly and indirectly, tourism provides approximately 7% of the employment in South Africa.

**Poverty**

Employment provides income for households and reduces the level of poverty. The Department of Tourism is involved in poverty-relief projects that promote the development of community-owned tourism products and services.

**Externalities**

Externalities are defined as costs or benefits that arise from production or consumption and affect someone else other than the producer or consumer. Tourism policy should ensure that tourism has the maximum positive impacts while minimising its possible negative effects.

**Human and environmental costs**

Tourism can have a negative impact on the environment. Tourism involves transport and transport can be a major source of pollution. Tourism policy needs amongst other things to ensure that tourists are transported in an environment friendly way. An example is the Gautrain which is an environmentally friendly way to travel.

Human costs might include communities that are displaced from their land to make way for tourism development. This undermines the community's rights and livelihoods.

The following strategies can reduce the negative effects of tourism:

- Promote community conservation areas.
- Promote collaborative tourism initiatives in order to ensure greater benefits to everyone involved.
- Promote community participation at different levels.
- Ensure that the benefits associated with tourism are spread evenly across society.
- Rewarding those who are directly involved in conservation.

**Infrastructure**

A high number of tourists can put pressure on existing infrastructure. This infrastructure can be upgraded if it will help promote increased tourism. The additional income can help to finance these upgrades.

# Unit 3 The benefits of tourism

## 3. 1. Introduction

The tourism sector's goal is to develop responsible tourism and deliver a memorable experience to all visitors and sustainable benefits for all South Africans.

The following types of income result from tourism:

- Direct expenditure - tourist expenditure on goods and services
- Indirect expenditure - expenditure by people supplying goods and services to tourists
- Induced expenditure - increased consumer spending as a result of additional personal income generated by the direct expenditure.

**Households**

The tourism sector creates many direct and indirect jobs. When infrastructure is improved to promote tourism, households benefit because they get to use it. Households therefore use the infrastructure to satisfy their own needs and to improve their standard of living. An example of this is the Gautrain.

**Businesses**

The barriers to entry are low in tourism and this gives entrepreneurs the opportunity to start new businesses. The government uses incentives to try and promote new businesses.

Businesses that are not involved directly in tourism also benefit from the industry. For example, the construction industry benefits when new hotels are built.

**The government**

The government benefits through an increase in tax revenue. The government may levy a small tax to cover the cost of providing services such as showers and public toilets at a beach. The government also charges tax in the form of airport departure taxes and hotel room occupancy and tickets taxes. An increase in employment also helps the government alleviate poverty.

# Unit 4 South Africa's profile (indigenous knowledge systems)

## 4. 1. Countries contributing to South Africa's tourism

The largest number of overseas tourists in 2010 came from the UK, USA and Germany. There has also an increase in the number of tourists from India and China in the last few years. Foreign tourists visit South Africa for holiday, business and study purposes.

The most popular tourist destinations in South Africa as voted for by foreign tourists are:

- Victoria & Alfred Waterfront
- Table Mountain
- Cape Point
- Western Cape Wine routes
- The Garden route
- Kirstenbosch National Botanic Gardens.

## 4. 2. Indigenous knowledge systems (IKS)

Indigenous knowledge (also called traditional knowledge) refers to the large body of knowledge and skills that has been developed outside the formal educational system. It is dependent on culture and heritage. The Department of Health has developed the Traditional Health Practitioners Act and Cabinet adopted an Indigenous Knowledge System Policy to stimulate and strengthen the contribution of indigenous knowledge to social and economic development in South Africa. Cultural tourism exposes tourists to South African indigenous culture, history, and local people so that they can have a better understanding of how local people live and work.

# Unit 5 Policy suggestions

## 5. 1. Policy suggestions

The Department of Tourism (DT) is responsible for formulating and implementing tourism policy in South Africa. Some factors that may contribute to successful policy aimed at increasing tourism are:

- A complete tourism package - tourists need access to a complete range of facilities and services. Policy needs to ensure all facilities are available.
- Strategic planning - resources should be utilised in a way that both the tourists and the local community get the maximum benefits.
- Encourage strong coherent leadership - policies should aim to ensure that all leaders and stakeholders work together.
- Support of local government - local government must get involved to encourage tourism.
- Encouraging local entrepreneurs - entrepreneurs should be encouraged to work together.
- Encouraging the private and public sector - these two sectors need to work together to ensure the promotion of tourism.
- Travel agencies and travel conventions - local entrepreneurs cannot market their businesses without the right platforms.
- Multilateral cooperation - successful collaboration between countries helps to encourage tourism.

**The National Tourism Sector Strategy (NTSS)**

In July 2010, the Department of Tourism launched the draft National Tourism Strategy (NTSS). The NTSS describes the strategies and policies necessary to create the conditions for future growth in the tourism sector.

.

The main objectives of the strategy include:

- To increase the tourism sector's contribution to gross domestic product (GDP).
- To achieve transformation in the sector.
- To provide excellent people development and decent jobs within the sector.
- To develop and entrench a culture of travel among South Africans.

**The marketing strategy**

South African Tourism (SAT) spends a great deal of money marketing and advertising South Africa to both global and local travellers.

Through its marketing strategy, SAT promotes the following initiatives:

- The Welcome campaign
- The Welcome Awards
- The Sho't Left Campaign
- Tourism Indaba
- Tourism Enterprise Partnership.

**Directing the spatial distribution of tourism**

It is important that the benefits of tourism be spread as evenly as possible across South Africa. A major challenge in achieving this equal spread is a lack of infrastructure that supports tourism. The Spatial Development Initiative was introduced to address this issue. This initiative supports communities that wish to develop tourism by:

- offering professional and appropriate advice and training
- providing relevant infrastructure to communities.

**The critical role of infrastructure**

Well established infrastructure is needed for tourism to be successful and sustainable.
The following policy guidelines apply to the provision of infrastructure:

- The continuous maintenance and upgrading of existing infrastructure
- Improve the accessibility and infrastructure in rural areas.
- Use modern computer and communications technologies
- Facilitate the funding of major tourism infrastructure projects
- Consider Southern African tourism potential when developing major tourism-related infrastructure projects.
- Work closely with the Department of Transport to improve transport
- Continually review current road signage to ensure maximum customer satisfaction.
- Expand tourism infrastructure as long-term strategy
- Pay attention to the negative environmental impact caused by the building of infrastructure for tourism.

## Questions

1 List and briefly describe the objectives of tourism policy. (4)

2 Provide an overview of the potentially negative impact of tourism on a country. (10)

3. Explain how an increase in tourism will affect capital formation, unemployment and growth in South Africa. (10)

3 Define a tourist . (4)

4 Write a short essay on the factors that affect growth of the tourism industry in particular country. (40)

5 Discuss the potential negative and positive impact of tourism on a country. (40)

# Topic 6 Basic economic problem: environmental sustainability

## Overview

In this topic, you will learn about:

- The state of the environment
- Measures to ensure sustainability
- Major international agreements (Rio de Janeiro and Johannesburg summits).

The state of the environment

- Air pollution
- Land pollution
- Water pollution

Measures to ensure sustainability

- Market based policies
- Public sector intervention

-taxes

-subsidies

-charges

Major international agreements

- The Rio de Janeiro Summit
- World Summit on Sustainable Development (WSSD)

# Unit 1 The state of the environment

### 1. 1. The South African environmental outlook

The word *environment* refers to everything around us: land, water, air, plant and animal life. Environmental degradation and the effects of climate change are major development issues. South Africa's main environmental concerns are:

- high levels of carbon dioxide emissions
- overexploitation of fish stocks
- access to basic sanitation
- large population that continue to live in informal dwellings.

South Africa's most significant environmental challenge is its reliance on coal-based energy that produces high levels of carbon dioxide emissions.

A loss of biodiversity can have a devastating effect on the environment because a sustainable environment relies on the balanced interactions between the various life forms that live within the ecosystem. All major ecosystems in South Africa are threatened in one way or another.

**Pollution**

Pollution occurs when the environment is contaminated by a chemical or other agent that renders part of the environment unfit for its intended use. Pollution damages the environment and interferes with human health and the natural functioning of ecosystems.
Examples include:

- Air pollution
- Water pollution
- Land pollution.

**Conservation**

Conservation deals with the sustainable use and management of natural (renewable and non-renewable) resources to ensure that they are available for use by future generations.

**Preservation**

Preservation deals with those aspects of the environment that are threatened with extinction. Environmental preservation is an essential basis for sustainable development and poverty alleviation. The Department of Environmental Affairs has developed a number of programmes to preserve resources.

# Unit 2 Measures to ensure sustainability

The loss of biodiversity and ensuring sustainability has to be addressed at both local and international le There must be an awareness that this is a serious problem that needs to be addressed. There are a number of approaches that can be used to ensure environmental sustainability.

## 2.1 Market-based approaches

The aim is to ensure that the price of goods and services reflect both social and private costs.

**Market failure**

Production often generates pollution that destroys the environment. Producers should therefore be responsible for the social cost of the environmental damage they cause.

### 2.2 Public sector interventions

Government can control the levels of pollution and environmental degradation though legislation. They can pass laws that prohibit any activity that poses an immediate or potential future threat to the environment.

**Taxes**

The government can levy various types of taxes to correct negative effects on the environment.

**Emission charges**

The government sets a price per unit of pollution. The pollution fee is a charge based on the quantity and or content of pollutants released into the environment.

**Marketable permits**

Instead of imposing taxes or emission charges on polluters, the government can assign each potential polluter with a permitted pollution limit. Each firm is issued with a permit to emit a certain amount of pollution. Firms can buy and sell these permits and prices determined by the market.

**Environmental subsidies**

The government can provide subsidies to firms to encourage them to make their production processes more environmentally friendly.

## Unit 3 Major international agreements (Rio de Janeiro and Johannesburg summits)

### 3.1. International agreements

South Africa is a signatory to a variety of international agreements that deal with environmental issues and environmental sustainability. The United Nations (UN), International Monetary Fund (IMF), World Bank and World Trade Organisation (WTO) strive to achieve the support and cooperation of all countries for the fight against environmental deterioration. Examples of international agreements include the Rio summit 1992 and the Johannesburg Summit 2002 .

**The Rio de Janeiro Summit**

The United Nations Conference on Environment and Development (UNCED) is an Earth Summit that took place in Rio de Janeiro in 1992. The UNCED had the aim of building on the declaration adopted at Stockholm on 16 June 1972. The purpose of the Earth Summit was to establish objectives and sign a number of conventions and treaties to address the deterioration of the global environment.

**World Summit on Sustainable Development (WSSD)**

The World Summit on Sustainable Development took place in Johannesburg in 2002.. The agreements reached in Johannesburg are guidelines for the action required to halve poverty by 2015. The agreement also incorporated decisions taken by world bodies since the Rio Earth Summit in 1992. The greatest success of the World Summit on Sustainable Development was turning the UN Millennium Declaration into concrete programmes. These programmes are aimed at the following goals:

- To halve the number of people without basic sanitation and access to safe drinking water.
- To restore collapsed fish stocks by 2015.
- To phase out, by 2020, the use of chemicals detrimental to the health of the population.
- To extend energy services to households over the next 10 years.

## Questions

1. Discuss what can be done to ensure that biodiversity is taken into account when deciding on the viability of a new project. (4)
2. Discuss the outcomes of the Rio summit held in 1992 in Rio de Janeiro. (16)
3. Explain why climate change requires a global effort. (6)
4. Distinguish between adaptation and mitigation. (6)
5. Explain why carbon emissions may be regarded as an externality. (6)
6. Write an essay in which you argue that economic policy that addresses the problem of climate change is necessary. (50)

**Term 1**

**Topic 1**

1. Households (consumers), firms (business enterprises), government (public sector) and the foreign sector. (8)

2. In economics a household is any number of people that live together and make joint economic decisions. A household can consist of one person or a number of people. They sell their factors of production (productive resources) to the factor market. (4)

3. A leakage happens when money leaves the circular flow and decreases the amount of money in circulation in the economy. (4)

4. An injection happens when money enters the circular flow and increases the amount of money in circulation in the economy. (4)

5. Final consumption expenditure by households (C) + Gross capital formation (I) + Final consumption expenditure by general government (G). (4)

6. Although there are many different markets in macroeconomics we group all these markets together and consider the goods market as a single market. (4)

7. Money market and capital market (4)

8. Foreign trade requires foreign currencies and these currencies can only be exchanged in the foreign exchange market. If you import goods from the United Kingdom you will have to pay for them in pounds and if you export goods to the USA you will be paid for them in dollars. (8)

9.

a. Gross domestic expenditure represents the spending by households, firm and government between the borders of South Africa. ✓ Included in this figure is spending on imports. ✓ Expenditure on gross domestic product is the spending by households, firms government and the foreign sectors ✓on domestically produced goods and services✓.

b. Spending on capital goods used in the production of goods and services. ✓✓
c. R1 077 833 million ✓
d. R2 141 621 million ✓
e. R9210 million ✓
f. R238 567 million ✓
g. R1 460 911 million ✓
h. Less ✓
i. Because we have spend more on imports than the rest of the world has spend on our exports. ✓✓
(14)

10.

| Variable | Leakage or Injection | Reason |
|---|---|---|
| Savings | Leakage ✓ | The item savings is a leakage since it is part of the income of households that is not spent. An increase in savings by households will decrease the flow of spending, production and income since households spend less on consumption. ✓ ✓ |
| Investment | Injection✓ | Investment is an injection when domestic firms buy more capital goods from other domestic firms and the flow of spending, production and income increases. ✓ ✓ |
| Taxation | Leakage✓ | Taxation is a leakage since it decreases the disposable income of households. As the disposable income of households decreases, households spend less and the flow of spending, production and income decreases. ✓ ✓ |
| Government spending | Injection✓ | Government spending is an injection. An increase in government spending increases the spending on goods and services and the flow of spending, production and income increases. ✓ ✓ |
| Imports | Leakage✓ | Imports are spending on foreign goods and services. If spending on foreign goods and services increases, less is spent on domestic goods and the flow of spending, production and income decreases. ✓ ✓ |
| Exports | Injection✓ | Exports are an injection. If we sell more goods and services to the rest of the world, the flow of spending, production and income increases. ✓ ✓ |

**Topic 2**

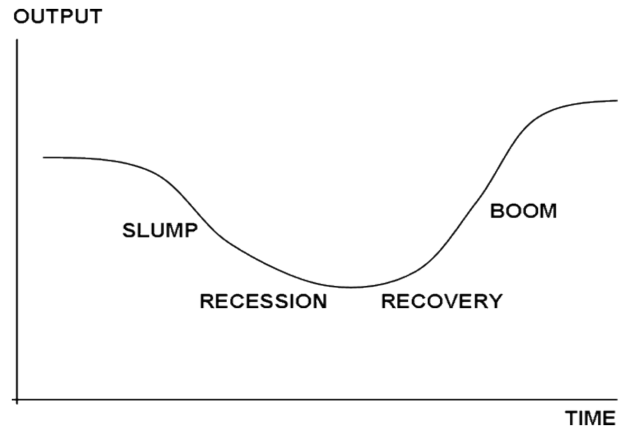
1. Expansion is characterised by growth in real GDP and income. ✓✓ It consists of two phases – recovery and prosperity (also called the boom). ✓✓ (4)

2. Contraction is a period of gradual decline in economic activity. ✓✓There is a decrease in aggregate demand that forces a decrease in output. ✓✓(4)

3.

- JSE all share index
- Money supply (M1)
- Consumer price index
- Factory hours worked opinion survey
- Business cycle indicators of our major
- trading partners
- Manufacturing orders opinion survey
- Inventory versus demand opinion survey (any 3)(6)

4.




**Contraction phase** ✓ is the downward phase of the business cycle. During this phase spending declines, gross domestic product falls, employment decreases, business confidence declines and income falls. ✓ ✓

**Trough** ✓ is the point where the economic contraction is at its lowest. ✓ It is followed by an expansion. ✓

**Expansion phase**✓ occurs when economic activity rises. This is reflected in an increase in spending, gross domestic product and employment. ✓ ✓

**Peak**✓ is the point where the economic expansion is at its highest✓, after which it is followed by a contraction✓.

( 4 for diagram and 12 for note) (16)

5.

| Variable | Contraction phase |
|---|---|

| | |
|---|---|
| a) Gross domestic product | Decrease✓ |
| b) Level of economic activity | Decrease✓ |
| c) Total spending | Decrease✓ |
| d) Level of production | Decrease✓ |
| e) Consumer spending | Decrease✓ |
| f) Investment confidence | Decrease✓ |
| g) Investment spending | Decrease✓ |
| h) Imports | Decrease✓ |
| i) Inflation | Decrease✓ |

(9)

6. During the upswing imports increase ✓which negatively affects the balance of payments ✓and leads to a depreciation of the exchange rate and an increase in the interest rate✓. These factors then impact negatively on the economy and a slow-down occurs✓. Or it might be that the increase in total spending leads to an increase in inflation✓, which negatively impacts on the level of economic activity✓. (6)

7. Exogenous factors are factors that have nothing to do with the business cycle such as natural disasters or droughts. It is not possible to control these factors. ✓✓✓Endogenous factors are factors within the business cycle such as changes in interest rates or changes in aggregate demand. These factors can be controlled to a certain degree. ✓✓✓ (6)

**Topic 3**

1. Fiscal policy is used by a government to adjust its levels of spending in order to monitor and influence a nation's economy. ✓✓✓✓ (4)

2. Economic growth✓✓
   Full employment✓✓
   Price stability✓✓
   Exchange rate stability. ✓✓
   Economic equity. ✓✓ (10)

3. The slow delivery of housing, the long queues at various government departments such as home affairs and clinics and the lack of response from government officials to complaints. ✓✓ ✓✓
(2X2)(4)

4. To provide public goods and services

There are some goods and services which would be under-provided if left to the market mechanism because some people would be unwilling to share in paying for them pay for them even though in the public interest. ✓✓

To provide merit goods.

Merit goods are goods that provide more public benefit than private benefit and include services such as education and health care. ✓✓

To protect natural resources.

If people are allowed to use resources such as oceans and rivers insensitively and carelessly it can cause damage. ✓✓

The redistribution of wealth and income.

One aim of the public sector may be to obtain a more equitable distribution of income and wealth. ✓✓

To manage the economy.

The market system does not necessarily bring about higher employment, price stability and an acceptable economic growth rate. The government can apply suitable government policies in order to achieve these objectives. ✓✓

To encourage competition.

Over time an unrestrained market economy could lead to the creation of monopolies which operate against public interest. The government acts to prevent monopolies and encourage competition. ✓✓

To regulate the level of economic activity.

The public sector can influence levels of economic activity through government spending and taxation. ✓✓ (14)

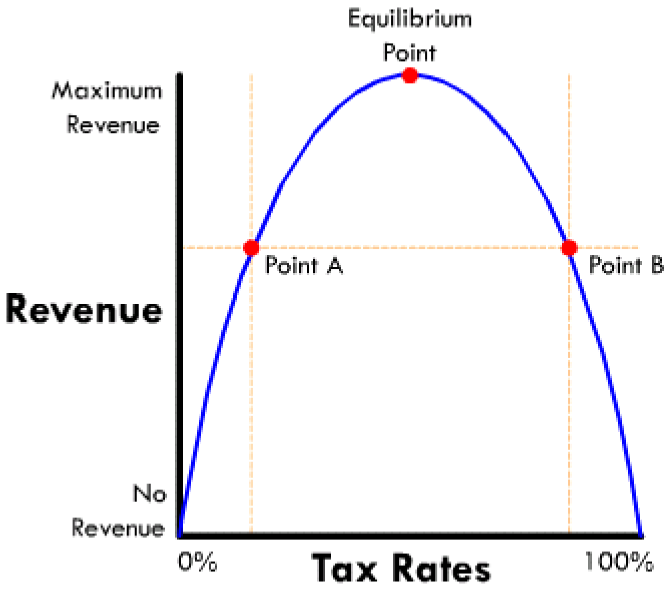
5. Management and accountability - there is often a lack of leadership and because state owned businesses are not directly accountable to tax payers, personal objectives are often put before the welfare of the people. ✓✓

Pricing and market forces - demand and supply are not the controlling factors in state owned enterprises which makes it difficult to determine the needs of the consumers and the market price. ✓✓

Long term motivation - Business success is often determined by long term effectiveness, productivity and strategies. ✓✓

Corruption, change in leadership, lack of competence and motivation often leads to the failure of state owned businesses. ✓✓ (8)

6.




A Laffer curve shows the relationship between tax rates and government revenue. ✓✓The curve suggests that at a zero tax rate the government would earn no revenue. it also shows that as it moves away from a zero rate, government revenue increases until a certain point where people prefer not to work or not to work so hard ( no overtime) thus reducing tax revenue. ✓✓This can reach the extreme where the tax rate is 100% and nobody will be willing to work as all their money would go to the government. ✓✓ If this happens tax revenue will be zero as nobody is earning an income. ✓✓( 8 for diagram and 8 for explanation)

7 a. Accountability √√Public servants do not always act in the best interests of the public as they are often driven by self-interest. √√ Also the public sector is not driven by a profit motive and the public cannot choose to go to other providers. √√This can lead to low productivity, laziness and a lack of accountability ( taking responsibility for your actions) amongst civil servants. √√Another problem is that public corporations are accountable to parliament rather than to the taxpayers that they serve. √√(5 x 2=10)

b. Efficiency√√ Anywhere in the world the public sector is notoriously inefficient. √√There are three major reasons for this:

- Bureaucracy and red tape - some officials are so focussed on complying with procedures and rules that they become insensitive to the needs of the people they serve. √√
- Incompetence - for various reasons civil servants often lack the skills or ability to do their tasks successfully. √√
- Corruption - civil servants often exploit their positions for personal gain. √√( 5 x 2 = 10)

c. The problem of assessing needs and correct planning. √√ In the private sector goods and services are supplied in response to effective demand. √√ In the public sector goods and services are provided according to the needs of citizens. √√. Public enterprises do not operate under market conditions and therefore do not have a mechanism to communicate the needs of the consumers to civil servants. √√This creates a problem which can lead to an undersupply of public goods or inefficient forecasting of future needs. √√ An example of this is the current electricity crisis. √√ In the private sector the laws of demand and supply would result in market equilibrium being reached and the correct quantity of a good being supplied at the correct price. √√ ( 5 x 2 = 10)

d. The problem of correct pricing√√ It is not always possible to charge the correct market related price for public goods and services because many people would be unable to afford these but should not be excluded from their benefits. √√ Providing goods for less than they cost or free of charge means some users have to cover the shortfall. √√ A further difficulty is that free services and goods are frequently abused, encouraging waste, for example people applying for unemployment benefits when they are in fact employed in the informal sector. √√This makes the pricing option for the public sector very complicated. √√ The government has several options when it comes to pricing: It can charge low income earners less than high income earners or it can provide goods that people pay extra to use for such as a toll road. √√ It can give subsidies to low level income earners or it can provide goods free of charge to the very poor or certain quantities of selected goods can be provided free of charge. For example water . √√ ( 5 x 2 = 10) MAX 40. Include an introduction and conclusion.

8. Income distribution √√- the government can redistribute income by using a progressive tax system and by spending on social goods, security and welfare. √√ This spending supplements the income of the poor as it provides them with free services and cash grants. √√ ( 2 x 2 = 4)

Consumption√√ - Direct and indirect taxes will affect both the total amount and pattern of consumer spending. Direct taxes reduce disposable income but the effect on consumption will depend on the propensity to consume and level of saving. ( 2 x 2 = 4)

Price level - taxes affect consumer spending patterns and the amount spent. √√ Increases in direct taxes reduce disposable income, which may lead to reduced aggregated demand. √√This in turn could reduce inflationary pressure. √√ ( 2 x 2 = 4)

Sector growth - taxation -√√ through increasing or decreasing taxes the government can encourage or discourage growth in a specific sector. √√ For example, if clothing companies pay less tax when they export, the creation of a clothing company industry will be encouraged. √√Increasing taxes on certain product can discourage consumers from using them e.g. cigarettes and alcohol. √√ ( 2 x 2 = 4) [16]

**Topic 4**

1.
a) The factors of production (natural resources, labour, capital and entrepreneurship) are unevenly distributed. √√
b) Climates vary from country to country. √√
c) Not all countries enjoy the same availability of technology. √√
d) Not all countries have an educated, skilled and productive labour force. √√

e) The principle of absolute advantage apply. √√ (6 x2)(12)

2. The Law of absolute advantage states that a country should specialize in the production of that which it is best at making. √√ The law of comparative advantage states that under certain conditions two countries can gain from trade even if one of them is more efficient than the other in producing everything. √√ (4)

3. In a floating or flexible exchange rate system the exchange rate is determined market forces of demand and supply without any intervention by the government or central bank The external value of the currency is allowed to find its own value against other currencies through the forces of demand and supply in the foreign exchange market. The value will then rise or fall according to changes in supply and demand. √√√√√√(6)

4.

| **Event** | **Shift** | **Depreciation or appreciation of the rand/dollar exchange rate** |
|---|---|---|
| a) An increase in the number of tourists visiting South Africa | Supply curve shifts right ✓ | Rand appreciates ✓ |
| b) An increase in the international demand for gold | Supply curve shifts right ✓ | Rand appreciates ✓ |
| c) An increase in the amount of capital goods that South African firms buy from the rest of the world | Demand curve shifts right ✓ | **Rand depreciates** ✓ |
| d) An increase in the amount of imports households buy | Demand curve shifts right ✓ | **Rand depreciates** ✓ |
| e) A decrease in the amount of foreign bonds bought by South Africans | Demand curve shifts left ✓ | Rand appreciates ✓ |

| | | |
|---|---|---|
| f) A decrease in fixed investment by foreigners in South Africa | Supply curve shifts left ✓ | **Rand depreciates** ✓ |
| g) An increase in the amount of South African bonds bought by foreigners | Supply curve shifts right ✓ | Rand appreciates ✓ |

(14)

5.

a. increase

b. more

c. increase

d. decrease

e. decrease (10)

**Term 2**

**Topic 1**

1. Free trade is a situation in which imports and exports flow freely between different countries of the world. (2)

2. Export promotion means that the government assists and encourages local firms to sell goods and services in international markets. (2)

3. Import substitution occurs when the government of a country encourages the use of locally made goods and services rather than imported ones. (2)

4.

- Improves global efficiency: Resources are allocated more efficiently as markets expand.
- Specialisation: Free trade allows countries to specialise in industries where they have a competitive advantage.
- Economies of scale: Costs can be significantly reduced if businesses take advantage of the economies of scale a global market offers.
- Innovation: Increased competition encourages innovation.
- Spreads democratic values: Businesses that trade on an international basis have to comply with international law.
- Choice: Consumers are free to buy goods and services from anywhere in the world.

- Lower prices: Specialised production and an efficient allocation of resources leads to lower prices. (14)

5 The Southern African Customs Union (SACU.) √√ The SACU consists of South Africa, Botswana, Lesotho, Namibia and Swaziland. These countries jointly negotiate free trade areas with other countries. √√

The Southern African Development Community (SADC) √√The SADC is a free trade area and its member countries are interested in forming an economic and monetary union. √√

The African Union (AU) √√ The AU exists to promote cooperation between the countries of Africa. Its economic development programme, called the New Partnership for Africa's Development (NEPAD) encourages regional cooperation and integration. The AU would like all African countries to join together to form an economic and monetary union. √√

The European Union (EU) √√The EU-SA free trade agreement encourages increased trade between the two signatories. SA has agreed to certain targets concerning reduced tariffs on goods traded between itself and the EU. √√

Mercusor. Mercusor is a regional trade area (RTA) √√consisting of Brazil, Argentina, Paraguay and Uruguay. In 2000 SA agreed to work towards a free trade agreement between SACU and Mercusor. √√

(4 x 4 = 16)

6 Increased employment more local workers√√ needed to produce goods previously imported. √√

More choice√√ because more variety in the country. √√

Diversification in the local economy√√ as more types of goods are produced. √√

Less vulnerable to fluctuations in foreign prices and actions √√as goods are produced locally. √√

( 4 x 4 =16)

7. Protecting infant industries√√ - new industries often cannot compete with established industries of foreign competitors. √√

Stable wages and standards of living -√√ workers jobs are not threatened by imported goods competing with locally produced goods. √√

Local businesses are protected √√and dumping is prevented. √√

Strategic industries are protected √√and economic self sufficiency is encouraged. √√

Balance of payments is corrected √√and exchange rates are stable. √√

Government earns revenue from import tariffs. √√

(4 x 4 = 16)

8. Other countries may retaliate√√

Local industries do not need to be competitive√√

Consumers have less choice√√

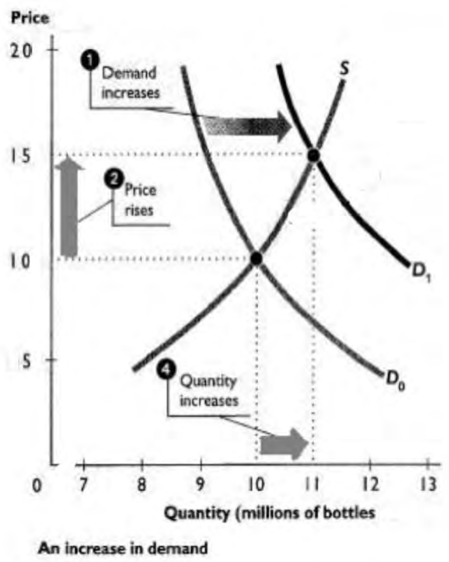
Prices of goods tend to be higher √√ (3 x 2 = 6)

**Topic 2**

1 a) Many buyers and sellers For a perfectly competitive market to exist there must be many buyers and sellers (producers) of a specific product. √√
b) Homogeneous product Examples of homogeneous products are agricultural products, metals, electricity and water. √√
c) Perfect information All market participants (buyers and sellers) have complete and correct information about market conditions. √√
d) No collusion In a perfectly competitive market, each buyer and seller acts independently from one another and no collusion occurs. √√
e) Freedom of entry and exit Buyers and sellers are completely free to enter or leave a market. There are no barriers to entry √√
f) Mobility of the factors of production The factors of production such as labour, capital and entrepreneurship can easily move from one geographical area to the next and from one industry to the next. √√
f) Unregulated market The government does not interfere in the markets. Decisions are left to individual sellers or producers and buyers. √√ (14)

2. Normal profit is equal to the best return that the firm's self-owned, self-employed resources could earn elsewhere. ✓✓
Economic profit is the extra profit that owners receive above the minimum payment required (the normal profit) by the owners of the firm to stay in the particular business. ✓✓ (4)
3.

a)




✓✓ ✓✓ (4)

3b The entire demand line for the individual supplier will shift upwards as a horizontal line because he can now supply an amount more that the new equilibrium price. ✓✓ (2)

4

| Structure | Number of firms | Characteristics of product | Market power | Entry and exit |
|---|---|---|---|---|
| Perfect competition | Many firms | Homogenous product | Price taker | Free |
| Monopolistic competition | Many firms, but less than perfect competition | Heterogeneous product | Price maker | Free |
| Oligopoly | Few firms | Heterogeneous | Price maker | Restricted |
| Monopoly | One firm | Unique product | Price maker | Completely blocked |

(4x4) (16)

5.

| Quantity (Q) | Price (P) | Marginal Revenue (MR) | Marginal Cost (MC) | Contribution to profits |
|---|---|---|---|---|
| 1 | 6 | 6 | 2 | 4 |
| 2 | 6 | 6 | 3 | 3 |
| 3 | 6 | 6 | 4 | 2 |
| 4 | 6 | 6 | 5 | 1 |
| 5 | 6 | 6 | 6 | 0 |
| 6 | 6 | 6 | 7 | -1 |

(12)

6 a) R15 ✓
b) R15 ✓
c) 120 ✓
d) R15 ✓
e) R12
f) 120 x R15 = R1 800 ✓✓
g) 120 x R12 = R1 440 ✓✓
h) It is making an economic profit of R1 800 – R1 440 = R360. ✓✓

8 In perfect competition there is freedom of entry ✓. If individual producers earn an economic profit, this will attract new producers ✓. The increased competition will force the market price down and economic profits will start to disappear. ✓✓

9. a) to increase efficiencies in markets ✓
b) to improve equity in markets✓
c)to ensure access to the markets to those people who were previously denied an equal opportunity to participate in the economy ✓
d) to assist in economic development. ✓ (4)

**Topic 3**

1. Technical efficiency occurs when the market produces the maximum quantity goods and services from a given set of resources. Allocative efficiency occurs when the market is producing the optimal mix of goods and services desired by consumers. ✓✓✓✓ (4)

2.

- Extended shopping and business hours (the decision to trade on Sunday is part of non-price
- competition) √√
- Doing business over the internet (banking and shopping) √√

- After-sales services √√
- Offering additional services (e.g. free travel insurance by banks) √√
- Loyalty rewards for customers √√
- Door-to-door deliveries √√ (any 4)(8)

3. There is only one seller of the product √
The good or service is unique and there is no close substitutes √
There are barriers to entry √
The monopolist is a price maker √
Lack of information on the part of sellers and buyers√
Control over factors over production, usually a natural resource√
Laws and restrictions may exist to prevent entry by other firms √ (8)

4 .

| **Criteria** | **Monopoly** | **Oligopoly** | **Monopolistic competition** |
|---|---|---|---|
| Number of sellers | Only one ✓ | Few large sellers ✓ | Many sellers✓ |
| Nature of product | Unique – no close substitutes ✓ | Homogenous or differentiated product✓ | Differentiated product✓ |
| Collusion between sellers | None since there are only one firm ✓ | Possible ✓ | Not possible ✓ |
| Restriction on entry | Completely✓ | Restricted✓ | Unrestricted✓ |

(12)

5. A monopolist since they are the only supplier of a product with no substitutes and entry into the market is restricted. . ✓✓
Depending on how firms in an oligopoly behave it possible to earn an economic profit. If oligopoly firms behave like monopolists they will be able to earn an economic profit. . ✓✓ (4)

**Topic 4**

1. Cost- benefit analysis (CBA) is an accounting tool investment whereby the total cost of the particular project is weighted against its total benefits. ✓✓ The government can use CBA to decide whether or not they should undertake a certain project. ✓✓ (4)

2. Market failure occurs when the market fails to achieve technical or allocative efficiency. ✓✓ (2)

3. Community goods such as defense, police services, street lights etc. √√√√

Collective goods such as parks, beaches, streets, public transport, etc. √√√√ [8]

4. Private costs (internal costs). These are the costs that producers incur when they manufacture goods. √√ Social costs. These are the costs of goods or services to those who create them and to society at large. √√
[4]

5

5. 1 Identify all the benefits and costs. √√ Compare the social costs with the social benefits. √√If the social benefits exceed the social costs then the project should be considered. √√ If an investment does not earn more than would be received by leaving the money in the bank, there is little reason for the entrepreneur to undertake it. √√ The rate of return on a project and the idea that future costs and benefits can be discounted in reverse to give its present value is used in CBA. √√ The term "rate of return" means the income earned on an investment. √√
(10)

5.2 Traffic congestion, noise pollution, effect on existing nearby shops, any valid answer. √√ √√ √√ (6)

5.3 Extra shopping choice, economic growth and employment any valid answer. √√ √√ √√ (6)

5.4

$$\frac{\text{Sum of annual benefits over the useful life of the programme discounted to the present value}}{\text{Sum of all annual costs, including maintenance discounted to the present value}}$$

**or**

$$\frac{\text{Present value of economic benefits}}{\text{Present value of economic costs}}$$ √√ √√ (4)

[26]

6. Merit goods are those where a higher consumption of the good is regarded as good for society, √√the government makes use of subsidies, √√ for example on bread in order to make the good more affordable for people. Demerit goods are those considered bad for either individuals or society as a whole, such as cigarettes, the government imposes taxes√√ to discourage consumption by limiting or making the goods more expensive. √√ (8)

7. Subsidising goods and services to the poor√√
Transferring income directly to poor households in the form of grants√√
Providing certain goods and services free of charge √√
Job creation programmes√√
Progressive taxation system√√ (4 X 2) (8)

8. The following should be explained in detail: externalities - private costs and benefits, social costs and benefits, public goods - inability of the market to meet demand, merit and demerit goods, imperfect competition, lack of information, immobility of factors of production, imperfect distribution of income, free rider problem, plus explanation of each one (11 x 3 = 33 plus introduction and conclusion. [40]

**Term 3**

**Topic 1**

1. The demand-side approach emphasises the fact that for a country to have growth, there is a need to increase aggregate demand by making discretionary changes to monetary and fiscal policies. To ensure economic growth, there should be an adequate and growing demand for goods and services. Aggregate demand in the economy comprises consumption demand (C), investment demand (I), government demand (G) and net exports (X – M). (8)

2. Implementing strategies to increase your human resources such as training and education, developing work ethic and work attitudes. Manage and use natural resources in a responsible manner. Accumulate and build up capital goods. Advancement in technology stimulates economic growth and development and is important because amongst other things it helps the country to produce a wider variety of goods and improve the quality of goods and services produced. Entrepreneurs are very important to the development of a country. They identify opportunities and combine them with other factors of production to produce goods and services. (10)

3. The North/South divide is a socio-economic and political division that exists between the wealthy developed countries, known collectively as "the North" and the poorer developing countries, known as "the South". Although most nations comprising the "North" are in fact located in the Northern Hemisphere (with the notable exceptions of Australia and New Zealand), the divide is not wholly defined by geography. The North is home to four of the five permanent members of the United Nations Security Council and all members of the G8. "The North" mostly covers the West and the First World, along with much of the Second World. The expression "north–south divide" is still in common use, but the terms "North" and "South" are already somewhat outdated. As nations become economically developed, they may become part of the "North", regardless of geographical location, while any other nations which do not qualify for "developed" status are in effect deemed to be part of the "South. (8)

4. Human Development Index (2)

5 The following growth and development strategies had been implemented in South Africa since 1994:

- the Reconstruction and Development Programme (RDP) ✓
- the Growth, Employment and Redistribution Programme (GEAR) ✓
- the Accelerated and Shared Growth Initiative for South Africa Programme (AsgiSA) ✓
- The New Growth Plan (NGP) ✓

*The Reconstruction and Development Programme (RDP)*

The *RDP* was an integrated, coherent socio-economic policy framework that was implemented directly after our first democratic elections in 1994. ✓ It planned to mobilise people and resources with the intention of eradicating apartheid and to build a democratic, non-racial and non-sexist future. ✓The RDP was based on six principles:

i. an integrated and sustainable programme ✓
ii. a people drive process focusing on the needs of the population✓
iii. peace and security for all aimed at a non-violent society that respects all human rights✓
iv. nation building focusing on the needs of all members of society✓
v. linking reconstruction and development✓
vi. democratisation of South Africa in all aspects, including decision making processes on all levels✓

The RDP consisted of many proposals, strategies and policy programmes which could be grouped into five main policy programmes. ✓The five key programmes were:

i. meeting basic needs✓
ii. developing our human resources✓
iii. building the economy✓
iv. democratising the state and society✓
v. implementing the RDP✓

*The Growth, Employment and Redistribution Programme (GEAR)*

The GEAR built upon the strategic vision set out in the RDP, ✓i.e. the importance of all the objectives of the RDP was reaffirmed but it recognized *the implementation and macro-economic problems* that the government had been experiencing in *implementing* the RDP. ✓

The RDP placed much more emphasis on *disciplined economic policy*, ✓while still recognising that there were very serious needs that had to be addressed. ✓

*The Accelerated and Shared Growth Initiative for South Africa Programme (AsgiSA)*

AsgiSA resulted from Government's commitment to halve unemployment and poverty by 2014. ✓. The *Joint Initiative on Priority Skills Acquisition (Jipsa)* was established a month later to address the scarce and critical skills needed to meet AsgiSA's objectives.✓

AsgiSA identified six important factors which prevented South Africa from achieving the desired growth rate: ✓

i. The relative volatility of the currency ✓
ii. The cost, efficiency and capacity of the national logistics system ✓
iii. Shortages of suitably skilled labour, and the spatial distortions of apartheid affecting low-skilled labour costs ✓
iv. Barriers to entry, limits to competition and limited new investment opportunities ✓
v. The regulatory environment and the burden on small and medium enterprises (SMEs) ✓
vi. Deficiencies in state organisation, capacity and leadership. ✓

AsgiSA was not intended to be a government programme but a national initiative supported by all the key groups in the economy, business, labour, entrepreneurs and government and semi-government departments and institutions. ✓

*The New Growth Path (NGP)*

The *New Growth Path (NGP)* was released in November 2011. ✓This plan is designed to serve as a *framework for economic policy* ✓and to be the *driver of the country's job strategy*. ✓

•

The New Growth Path therefore proposes certain strategies to ensure *adequate demand:* ✓

- *Deepening*✓ the domestic and regional market by growing employment, increasing incomes and undertaking other measures to improve equity and income distribution✓
- *Widening*✓ the market for South African goods and services through a stronger focus on exports to the region and other rapidly growing economies✓

•

• On a *macro-economic level* the NGP entails accommodating or looser monetary policy, ✓combined with stricter fiscal policy to limit inflationary pressures and enhance competitiveness. ✓ Government spending will be prioritised with the objective of long term sustainable employment opportunities in mind. ✓

The *microeconomic measures* to control *inflationary pressures* include the following:✓

(a) *Competition policy* to supervise monopoly pricing on products and services✓

(b) A review of *administered prices* to ensure that they do not increase above inflation without compelling reasons✓

(c) Interventions in the case of rapidly rising prices of essential products and services, such as private healthcare and basic food items✓

The *microeconomic* package involves ten programmes to control inflationary pressures ✓and inefficiencies ✓combined with more proactive strategies to support an inclusive economy✓:

*i.* Active industrial policy✓

*ii.* Rural development policy✓

*iii.* Competition policy✓

*iv.* Stepping up education and skills development✓

*v.* Enterprise development: promoting small business and entrepreneurship; eliminating unnecessary red-tape✓

*vi.* Broad-based Black Economic Empowerment (BBBEE) ✓

*vii.* Labour policies✓

*viii.* Technology policy✓

*ix.* Developmental trade policies✓

x. Policies for African development✓ (50)

6 The NGP is a partnership approach to tackle inequality and unemployment in our society and this is the opposite of central planning. ✓✓ The section that proposes *salary caps* has drawn the biggest resistance. Business leaders are unhappy about the proposed freeze on bonuses and salaries for senior executives arguing that such a cap would be disastrous for productivity and could demotivate hardworking employees. Cosatu, also disagrees with wage caps don't like the salary caps because they could lead to even greater levels of income inequality. ✓✓ The plan is criticised for proposing an economic model that was too i*nterventionist* while the rest of the world is moving towards freer market models and less intervention. ✓✓

The NGP called for a loose monetary policy that also sought to avoid inflation. ✓✓ (8)

7. While most economists agreed with the AsgiSA initiative with its focus on identifying and unblocking the constraints on higher growth, there were also areas of concern. Issues such as crime✓, high tax rates✓, labour costs✓, corruption✓, and the costs of financing black economic empowerment✓ were not addressed in the strategy while economists were of the opinion that these should be addressed in a growth strategy✓. Some critics also felt that the private sector's opinions and needs✓ were not really addressed in the initiative ✓. (8)

8. **Percentage annual change in gross domestic product at market prices**
Indicates the change in GDP at market prices from one year to the next, as a percentage of the GDP at market prices in the first year. ✓Because it is measured at market prices , it also incorporates changes in the price level✓. A high inflation rate will therefore imply a large increase in GDP at market prices, but it does not mean that there was any increase in real production. ✓

**Percentage annual change in gross domestic product at constant 2006 prices**
indicates the change in GDP at constant prices from one year to the next, ✓ as a percentage of the GDP at constant prices in the first year. ✓ Because it is measured at constant prices, an increase in GDP at constant prices indicate an increase in real production. ✓

- 
- **Gross domestic product per capita at constant 2006 prices**

• Indicates the GDP per person in the country. ✓If GDP at constant prices increase but the population also increase, this will mean that the standard of living will actually come down. ✓GDP per capita provides of total production per person, and if this increases, this will ensure an increase in the standard of living of the population, i.e. it will indicate economic development. ✓

•
• **Income distribution**
• Indicates the distribution of the income earned in a country among the different income groups. ✓ If an increase in income is distributed equally among the population, this is a fair income distribution. ✓ However, if an increase in income is received mainly by the rich in an economy, while the poor a smaller part of an increase in income, this indicate a skew distribution of income. ✓
•
• **Human development index**
• The Human Development Index compiled by the United Nations is the most widely accepted indicator of life standard. ✓This index compares life expectancy, literacy, education and standards of living for all countries. ✓✓ (15)

**Topic 2**

1. A range of sectoral actions; a set of cross-cutting actions of particular importance for industrial policy; and measures to improve government's organisation and capacity to implement industrial policy. (6)

2. Total development as a multidimensional process, development of people, for people, by people, developments should start from within the region, it must concentrate on basic issues where the most urgent human needs exist, cooperation between the private and public sectors and the local community. (10)

3. Coega IDZ, Richards Bay IDZ, East London IDZ. (4)

4. The IDC has contributed to the restructuring of those sectors which experienced difficulties in the early 1990s. The IDC's investment patterns have shifted to support more labour intensive sectors and BEE objectives. IDC investments in BEE expansion projects have been the biggest creators of employment. This demonstrates the importance of broad-based activity in the economy for industrial development. (4)

5 *The Industrial Development Corporation (IDC):* a national development finance✓ institution set up to promote economic growth and industrial development✓. It is owned by the South African government ✓under the supervision of the Economic Development ministry✓. It provides finance for industrial development in South Africa and the Rest of Africa. ✓

- *Spatial Development Initiatives (SDIs):* a policy used in South Africa to foster sustainable industrial development✓ in areas where poverty and unemployment are at their highest✓. SDIs focus on providing high-level support in areas where government assistance may contribute to economic growth✓ and subsequent economic development✓.
- *Industrial Development Zones (IDZ):* a clearly delineated industrial estate or area✓ which constitutes a free trade enclave in the customs and trade regime of a country✓,

and where foreign manufacturing firms produce mainly for export, ✓benefit from a certain number of fiscal and financial incentives✓.

- *Development corridor:* a track of land that forms a passageway✓ allowing access from one area to another✓. Due to the corridor providing access to larger markets it enables high density✓ and thus more efficient production of agricultural, mining and manufactured goods✓.
- *Integrated Sustainable Rural Development Programme (ISRDP):* a 10-year programme geared to encourage sustainable development✓ in poor rural areas in South Africa✓. The point of departure of the ISRDP was that local government institutions should be developed to support development✓ while also emphasising assistance from the private sector to sustain this initiative✓. (20)

6 Economic integration in southern Africa is based on the premise that economic integration could yield greater developmental benefits ✓by the collective use of economic policies✓.Working together can be much more effective and efficient ✓ and a project that may not be viable for one country or region to undertake may become viable through cooperation✓. A strong union of African countries also have more bargaining power in a global context✓. (5)

7 *Industrial policy* should be aimed at ensuring that support is provided for all potentially viable sectors. Sectors should be evaluated in terms of opportunities✓ and shortcomings ✓to identify the most viable sectors in a region✓.

Small business has the potential to create lots of employment opportunities✓; therefore the degree to which policies contribute to *small business development* is very important. National, regional en industrial development policy should keep this objective in mind and should ensure encouragement of small business entrepreneurship✓. It should address factors that may inhibit small business development✓.

Regional and industrial development policy should also be aimed at the larger *community*. It should recognise that working together can be much more effective and efficient✓ and that a project that may not be viable for one country or region to undertake may become viable through cooperation✓. A strong union of a few countries also have more bargaining power in a global context✓.

Development policies should also address *labour practices* and should encourage labour-intensive growth ✓and a flexible labour market regime✓ that does not inhibit employers to employ labourers but should still protects labour✓. (15)

8 It is highly likely that the private sector is better equipped to identify the most effective investment opportunities✓. If the private sector does not buy into the development policy or plan, it will not be viable in the long run✓ as this will mean that government will have to keep on financing the project, which is unsustainable in the long run✓.

Well designed rural and industrial development policy will be done on an integrated approach✓. All parties that will be affected should be part of the design process✓. Partnerships should be initiated between the local community and the other parties involved, namely central government, local authorities, civil society, special interest groups, NGOs and the private sector. ✓ (6)

**Topic 3**

1 Economic indicators are used to evaluate the economic performance of an economic unit. International comparisons help to give a measure of how a country is performing against other countries. ✓✓(2)

2 Human Development Index gives a gives of the overall standard of living of people within a country ✓✓whereas GDP shows only increases in economic activity of a country and not whether the living standards of the population have improved. ✓✓HDI measures life expectancy, rates of education and literacy, population birth rate and other measures that indicate quality of life. ✓✓(6)

3 **Inflation rate:** There are different *indices* that can be used to calculate the inflation rate. The mostly used price indices are

- the consumer price index✓
- the production price index✓
- the GDP deflator✓

The *consumer price index* (CPI) is compiled by Statistics South Africa and measures the change in the price level of a basket of consumer goods and services. ✓The goods and services included in the basket are chosen to represent the goods and services purchased by an average household. ✓This basket is adjusted from time to time as consumption patterns change. ✓ The inflation rate is the percentage change in the CPI from the previous year and can be calculated as follows:

$$\frac{Change\ in\ CPI}{CPI} \times 100 \checkmark$$

The *production price index* (PPI), which is also estimated and published on a monthly basis by Statistics South Africa, is similar to the CPI, except that it also includes the prices of raw materials and intermediary goods (i.e. goods that will be finished in the production process), excludes VAT and excludes services. ✓Manufactured goods included in the PPI are priced when they leave the factory, not when they are sold to consumers. ✓Unlike the CPI, the PPI therefore cannot be related directly to consumers' living standards. ✓The PPI is nevertheless very useful in the analysis of inflation because it measures the cost of production. ✓A significant change in the rate of increase in the PPI is usually an indication that the rate of increase in the CPI will also change a few months later. ✓

The *GDP deflator* is a ratio that indicates the relationship of the GDP at nominal prices to the GDP at real prices: ✓

$$\text{GDP deflator} = \frac{\text{Nominal GDP}}{\text{Real GDP}} \times 100$$

Nominal GDP is the value of total gross domestic product measured at current prices, while the real GDP is the value of total gross domestic product measured at constant prices. ✓ Therefore the GDP deflator includes changes in the prices of exports✓ but not of imports. ✓ In a small open economy, like that of South Africa where both imports and exports are significant in relation to the total size of the economy, the exclusion of import prices is an important shortcoming. ✓

(ii) **Unemployment rate:** In terms of economic development, employment is a very important indicator. ✓ Employment is, however, not very easy to measure as so many people are employed in the informal sector which is not recorded. ✓ The concept of underemployment is also important. This is when someone is employed in a position lower than their ability, for example when a qualified accountant works as a delivery person because he/she cannot find employment as an accountant. Someone may also be employed on a part-time basis but would prefer to work full time. ✓

A labour force survey is published quarterly by Statistics South Africa. ✓This publication contains information and statistics concerning a variety of issues related to the labour market, including the official unemployment rate. ✓It is a very complete survey and provides information on changes in employment in different provinces and industries, employment in the informal sector, and even reasons for changes in employment figures. ✓ The unemployment rate is a percentage of the total labour force. ✓The total labour force includes all employed persons as well as unemployed persons looking for work. ✓ The unemployment rate is a lagging indicator, which means that it will only change a few periods after the trend in the economy has changed. ✓For example, if the economy starts growing at a faster pace, the unemployment rate will only react to this growth after two or three quarters. ✓

○

(iii) **Interest rates:** Interest rates are important indicators of future economic activity, as the interest rate level is usually an important determinant when economic decisions are being taken. ✓ Both the *general interest rate level* ✓and the *structure of interest rates* ✓are important indicators.

There are many interest rates in the economy. Some are short term rates, such as the repo rate which is the interest rate at which South African banks borrow from the Reserve Bank to finance their liquidity deficit. We call this accommodation and this loan from the SARB to a bank is for 7 days. ✓An overdraft on a current account is also a short term loan by a bank to a customer to finance a temporary deficit and therefore the interest rate on an overdraft account is also a short term interest rate. ✓When a household acquire a loan to buy a house, this loan called a home bond is usually for a 20 to 30 year period, therefore the interest rate on such home bonds will be long term interest rate. ✓ The difference between the short term interest rates and the long term interest rates is called the *interest rate spread* ✓and the *term structure of interest rates* provides an indication of the interest rate levels on loans or investments of different maturities. ✓ The curve representing the different interest rates on each date is called a *yield curve.* ✓ The yield curve shows the relationship between the maturity of an instrument and the yield or interest rate on it. ✓. A yield curve will usually have a positive slope because longer term loans and investments and regarded to be riskier due to the uncertainty (we simply don't know what the future holds!). ✓ However, if the yield curve becomes steeper, the higher long term interest rates indicate that interest rates are expected to increase in the future. ✓For example, usually when the inflation rate is high and people expect that the monetary authorities will put up the repo rate to bring the inflation rate down, the yield curve will become steeper✓. If the yield curve is inverted (i.e. it has a negative slope) this will indicate that interest rates are expected to decrease in the future. ✓

The difference between the short term rates and long term rates is called the interest rate spread or yield gap. ✓ This flatter the yield curve and thus the smaller the yield gap, the smaller the expectation that interest rates will change in future. ✓

The different interest rates will usually move together, i.e. when the repo rate goes up all other interest rates in the economy will also increase. ✓ This means that the whole yield curve will move upwards. ✓

Usually we can expect the interest rate level in a developing country to be higher than the interest rate in a developed economy. ✓This is due to the higher risk attached to the developing economy. ✓ Factors such as political and economic uncertainty cause this higher risk. ✓Developing economies also need to attract foreign investment to their country to finance growth. Investors' funds will move towards the highest yield and therefore developing countries cannot allow interest rates in their countries to become too low. ✓

In general a lower interest rate level will create an expectation that investment should increase and this should enhance growth, employment and development. ✓A higher interest rate level may inhibit borrowing and thus investment and this may be interpreted as an indication that the economy will grow slower. ✓ Economists have proved, however, that there lies more predictive power in the shape of the yield curve and the yield spread. ✓ When long term interest rates are lower than short term interest rates and the yield curve therefore has a negative slope (i.e. a negative yield spread), an economic downturn can be expected. ✓The larger the yield spread (i.e. the larger the difference between the lower long term interest rates and the higher short term rates) the more severe the recession of depression can be expected to be. ✓

(iv) **Money supply:** The increase in the M3 money supply is an important economic indicator. ✓

If M, the money supply increases, ✓ this means that either P (prices) or Y (output) has to respond to the increase in M. ✓ Therefore an increase in the money supply is an important indicator indicating that nominal output (PY) will increase. ✓Whether this will translate to an increase in real production or the price level, will depend on various factor in the economy. ✓One such factor is production capacity. ✓ If adequate capital equipment is available to increase production when there is an increase in aggregate demand, real production can increase. ✓However, if no excess production capacity is available or if producers are not willing or able to produce more goods and services, the result will be an increase in prices. ✓

Many economists are of the opinion that the direction of causality in the equation of exchange does not flow from money supply to nominal income, but that an increase in the money supply is the result of an increase in the price level and/or the real production level. ✓ Information on money supply growth and credit extension (one of the important factors causing a change in money supply) become available much quicker than information on production and price levels – therefore growth in money supply and credit extension are still important indicators, especially in the short run. ✓

Information on the growth in the M3 money supply is published regularly the SARB in the SARB Quarterly Bulletin. ✓ The reason for the growth in M3 as well as the implications thereof is also discussed in the Bulletin. ✓Credit extension to the private sector is an important determinant of M3 money supply. ✓When credit extension decreases, money supply growth also decreases. ✓When banks provide a loan to a customer, a deposit for the amount of the loan is created and therefore the M3 money supply is increased. ✓

- 4 Economic indicators provide:
- An indication of changes taking place in a country, e.g. an increase in real GDP per capita indicates economic growth✓✓
- An indication of how a country compares to other countries, e.g. when you compare South Africa's human development index with that of Zimbabwe✓✓
- An indication of trends or changes in the economy such as a recession✓✓ (6)

5 The *naïve extrapolation technique*✓: This method entails assuming that the future path of an economic variable will be determined by its current and recent path. ✓ For example: if the economy has been growing at a rate of 3 percent in the most recent past, you assume that it will continue to grow at 3 percent in the future. ✓

The *barometric approach*✓: Leading economic indicators are used to predict the future path of the economy, i.e. the *change* in economic activity rather than the *level* of economic activity✓. Examples of leading indicators may include the change in the number of new cars sold, the change in the number of building plans approved, the number of new companies registered and many more (Any one example ✓).

*Macroeconometric* models ✓ are based on macroeconomic models. There will be various economic indicators that will be used as inputs into the model✓. These are called *exogenous* variables✓. The future values of these exogenous variables may sometimes be based on extrapolation techniques, as discussed above✓. Other inputs into the model will be various *parameters* ✓that determine the relationship between economic variables✓. These parameters will be based on historical evidence✓. Examples of such parameters can be the marginal propensity to consume and the interest elasticity of investment (Any one example✓). The outputs of the model are the economic variables that are predicted using the model ✓and these are called the *endogenous* variables✓. (16)

6 *Net merchandise exports,* which is the difference between exports and imports of goods✓, is important in a developing economy, as a growing goods export sector can be associated with the creation of employment opportunities✓.

The *balance on the current account* provides an indication of the difference between exports and imports of goods and services✓. If the current account shows a positive balance, this means that exports exceed imports✓. If the current account shows a negative balance, this means that imports exceed exports✓. If this is the case, the country will need an inflow of foreign capital to pay for the excess of imports over exports✓. This flow of capital will be shown in the financial account.

While a positive balance or a *surplus* on the current account may seem like the healthiest option for an economy, as this will mean that adequate foreign exchange is available to finance goods that needs to be imported, this will not always be an attainable option in a developing economy✓. A developing economy will need to increase its available infrastructure and production capacity✓. To do so will often involve import of technology and capital equipment and therefore a developing country will often have a negative balance or a *deficit* on the current account✓. As long as such a negative balance can be financed with an inflow of foreign capital, this is not a problem✓. (10)

7 Because it occurs as a result of changes in the economy not as a cause. Firms lay off workers only after a downturn or employ more people only after the economy has picked up. (2)

**Topic 4**

1 Between inflation and purchasing power a negative relationship exits ✓. An increase in the inflation rate decreases purchasing power ✓. A decrease in purchasing power implies that less goods and services can be bought by given amount of money✓✓. (4)

2 Any three of the following:
Increased spending by households.
Increased investment spending by firms.
Increased spending by government.
Increased spending by the foreign sector. ✓✓✓✓✓✓ (6 marks)

3 Any three of the following:
An increase in wages and salaries.
A decline in productivity.
An increase in profit margins by firms.
Increase in the price of imported goods. ✓✓✓✓✓✓ (6 marks)

4 Any three of the following:
An increases in taxes to decrease the disposable income available to households.
A decrease in government spending.
A restrictive monetary policy entails the use of the interest rate to decrease total spending in the economy.
Limit the amount of credit available. ✓✓✓✓✓✓ (6 marks)

5. To deal with increases in wages an incomes policy can be used. ✓ ✓
To decrease the cost of production polices aimed at increasing productivity can be useful. ✓✓
T o decrease profit margins more competitive market can make a valuable contributions. ✓✓
(6)

6 Inflation has an impact on economic growth. Due to the distributional effect savings are discouraged and the less savings in the economy the less funds are available for real investment.

Inflation also impact on the investment decision. Why invest in productive assets if an investment in speculative assets such as shares, properties, foreign currencies, works of art, antiques, and so on which might bring a better return due to inflation. Instead of investing in productive assets, market participants try to outwit each other by speculating. Businesses become preoccupied with inflation and how they can beat it rather than worrying about more productive issues. Time and resources are wasted to anticipate inflation and protect oneself against it. ✓✓✓✓✓

Inflation also has an impact on the balance of payments. If the inflation rate in South Africa is higher than that of our trading partners it can have negative consequences for the balance of payments in that it increases the cost of the export industries with a resultant loss of international competitiveness. ✓✓✓

High inflation also impact on the functioning of the price mechanism. Changes in relative prices are important signal to both consumers and producers. With high inflation these price signal are more difficult to correctly interpret. It causes a noise in the system in the same way as a radio message is harder to interpret the higher the static in the system. ✓✓✓

High inflation also causes further inflation. This is the so-called inflation spiral which is caused by people's expectations about inflation. Since people expect inflation to continue, they do things that further fuel inflation and if this get out of hand the result might be hyperinflation. ✓✓
(12 marks)

7. (a) False
(b) True
(c) False
(d) False
(e) True
(f) False

**Topic 5**

1 The first important negative impact that tourism may have is on the environment✓. In the first place tourism involves transport, and transport in an important source of pollution. ✓

Tourists can also harm the environment by placing more pressure on natural resources such as water and beaches✓. If numbers of tourists are not controlled a lack of adequate resources may lead to such source becoming depleted or inadequate✓ Africa has many arid areas where lack of fresh water may become a problem if there is a too large influx of tourists. ✓

Similarly too many tourists may also put pressure on existing infrastructure. ✓Sanitation, ✓electricity provision services✓, road and rails ✓may be inadequate to provide in the additional need created by tourists.

When tourist visit natural and cultural heritage areas care should be taken to ensure that such areas are not negatively affected by the tourists. ✓ (10)

2 For every rand spend by a tourist, there is a multiplier effect ✓so that the total effect on income is much larger. ✓

Unemployment is the largest socio-economic problem in South Africa and because tourism is a labour-intensive industry it has the potential to contribute to alleviate unemployment✓. In 2010 the Pan African Research and Investment Services conducted a study on the role of tourism in South African and the factors that affect it. They found that when foreign tourism expenditure rises by 1%, fixed capital formation on average, increases by 0,04%✓ while employment increases by about

0,07%✓. Domestic tourism expenditure elasticities are 0,17% and 0,15% for fixed capital formation ✓and employment✓ respectively, meaning that a 1% increase leads to an increase in fixed capital formation of 0,17% and a 15% increase in employment. Tourism contribution to employment stood at 5% in 1994 and rose to 7,4% in 2008✓. To this increase direct tourism contributed 3% in 2008, whilst the rest resulted from the multiplier effects described above✓. With regard to tourism's contribution to GDP, the total effect increased from 8,5% in 1994 to 10,5% in 2008✓. In 2008, air tourists spent about R16,8 billion (R7 666 per person per trip) ✓; those from land markets (i.e. who entered using roads) spent R27,2 billion (R3 837 per person per trip✓) in the same period. From this research we can conclude that tourism contributes a large percentage to total GDP✓ and that this contribution is growing. ✓ Tourism is therefore an important industry in South Africa. It also indicates that an increase in tourism affects both capital formation and employment, and therefore it also contributes to economic development. ✓ (10)

3 People travelling✓ to and staying in places outside their usual environment ✓for not more than one consecutive year✓for leisure, business and other purpose ✓ (4)

4 The factors that affect *domestic tourism* is disposable income ✓but not by the interest rate level✓. **Foreign tourism** will increase due to an increase in world GDP (which is a proxy for income) ✓ and when the Rand/US$ exchange rate weakens✓, which of course, makes traveling to South Africa cheaper for foreigners. ✓

Factors that affect tourism worldwide are global exchange rate volatility✓, oil prices ✓and fuel hedging costs✓. Oil prices have an impact on aviation fuel prices✓, the cost structure of the global tourism market✓, and the affordability of access to long-haul destinations, such as South Africa✓. Putting a price on carbon emissions through carbon taxes or tradable carbon permits may also affect the price of traveling, and therefore the extent of tourism✓. Despite all these factors that may affect tourism negatively, it continues to grow✓. This is a worldwide trend. What contributes to this growth?

In the first place technology such as the internet and even travel shows on television that makes people more aware of the variety of traveling destinations may be an important factor that contribute to an increase in tourism activity✓. Technology also makes it easier for tourists to manage their own travel plans and to do research on different destinations✓. Therefore a presence on the internet is of the utmost importance for a country that wants to enhance tourism✓. The internet is definitely the most effective marketing tool available to the tourism industry – countries and regions should be aware of this and have a marketing strategy to encourage tourism, and also provide the means for smaller entrepreneurs to have access to this type of marketing✓.

Where travel was previously viewed as a luxury and mainly aimed at leisure activities✓, the profile is starting to change. More and more travel is seen as a necessity that enhances your knowledge and understanding of the world and the way in which it works✓. The demand for mass-based leisure tourism is being replaced by a desire to connect emotionally with destinations, local people and local cultures✓. More people are interested in combining unique travel opportunities with meaningful volunteer work✓. This trend creates important opportunities for developing countries and we should ensure that systems and strategies are in place to harness this changing tourism need✓.

The recent global financial crisis has fundamentally changed the profile or tourists✓. The working population in the European Union, which has traditionally been the most important source of tourists, is declining, as is Japan's✓. Tourism from emerging markets such as China, India and Latin America is increasing and expected to become very important in the near future✓. Tourism strategy and planning should take this into account and do research on the needs of such tourists✓.

As indicated in the previous section, the number of domestic tourists exceeds the number of foreign tourists by far, but foreign tourist spends much more than domestic tourists✓. This is contrast to Brazil where expenditure by domestic tourists exceeds expenditure by foreign tourists by far. This shows that there is an opportunity in South Africa to grow the domestic market, especially since a large part of our population are not culturally inclined to travel to unknown destinations due to our apartheid history✓.

An important reason for the increase in tourism is probably the increase in government expenditure on promoting and encouraging tourism✓.

The World Economic Forum Travel and Tourism Competitiveness Report indicates the strong and weak areas of different tourist destinations. According to this report South Africa's strongest areas are natural sites✓, cultural resources✓, attractive price competitiveness for hotel rooms✓, a favourable tax regime✓, good air transport infrastructure✓ and favourable policy rules and regulations✓. The weakest areas are safety and security✓, access to health services✓, ticket taxes and airport charges ✓and lastly inadequate human resources✓. Policies and strategies aimed at encouraging tourism should take into account the strong points and capitalize on them, while ensuring that the weak points are addressed so that even more tourists can experience our wonderful and diverse country✓. (40)

5. South Africa's New Growth Plan identifies tourism as one of the six core pillars of growth✓. Tourists spend and therefore an increase in tourism in a certain area will contribute to an increase in income in that area. ✓

The following types of expenditure resulting from tourism can be identified:

- **Direct expenditure✓:** This will involve the expenditure on goods and services by the tourists themselves in hotels, restaurants, shops, other tourist facilities, tourism generated export, i.e. goods that are purchased by the tourists as well as investment in an area specifically related to tourism, e.g. erection of accommodation facilities at a tourist destination. ✓
- **Indirect expenditure✓**: This is expenditure by those supplying services and goods to tourists, such as the goods purchased by the hotels and tourist shops. ✓
- **Induced expenditure✓** This is the increase in consumer spending that results from the additional personal income generated by the direct expenditure, e.g. the hotel workers using their wages for the purchase of goods and services. ✓

For every rand spend by a tourist, there is a multiplier effect so that the total effect on income is much larger. ✓

Unemployment is the largest socio-economic problem in South Africa and because tourism is a labour-intensive industry it has the potential to contribute to alleviate unemployment. ✓ When foreign tourism expenditure rises, fixed capital formation on average, also increases✓ Tourism contributes a large percentage to total GDP and t this contribution is growing. Tourism is therefore an important industry in South Africa. ✓It also indicates that an increase in tourism affects both capital formation and employment, and therefore it also contributes to economic development. ✓

An advantage of the tourism industry is that there are few entry barriers. ✓Entry barriers refer to obstacles that may make it difficult to enter a particular market. ✓ The funding requirements can be low, it is not a technology intensive industry and it does not involve skills that are particularly hard to master. ✓This makes the tourism industry a relatively easy industry to enter, even for persons with little educational background. ✓.

An added advantage of tourism is that, unlike all the other growth pillars, tourism also contributes to preserving our unique culture and heritage. ✓All the other growth pillars involve new ways of doing things and necessitate importing technology to
ensure competitiveness. Tourism, and especially rural and cultural tourism, contributes to preserving our indigenous knowledge systems. ✓

Tourism also plays an important role in establishing the character of our country and society. ✓ If foreign visitors to our country have a pleasant experience, this can contribute to strengthening international relations and building socio-economic and political networks that may benefit us in future. ✓Therefore, investment in tourism is also an investment into the image of our country. A country with a positive image may find it easier to secure foreign investment. ✓

If the foreign sector perceives our country to have a positive image, this will also contribute to national pride. ✓Enhancement of national pride can have a multitude of positive spin-offs such as taking better care of our environment, resources and our communities, including the elderly and the youth. ✓ National pride contributes to creation of a hopeful community that works towards the future. ✓

Although world tourism was affected by the global economic crisis that started towards the end of 2007, it has also proved to be one of the most resilient sectors of the economy ✓. Therefore tourism has the potential to contribute to bring an economy out of an economic slump. ✓

Tourism mainly has a positive impact on a country, especially from an economic perspective. However, there may be some important negative implications which should not be overlooked and should, ideally, be addressed before the problems become unbearable or unsolvable. ✓

The first important negative impact that tourism may have is on the environment. ✓ In the first place tourism involves transport, and transport in an important source of pollution. ✓ Policy should be in place to ensure that tourists are transported in the most environmentally friendly way, while still preserving their comfort. ✓ In many instances tourists, especially those interested in a more culturally authentic experience may prefer less comfortable, more environmentally friendly means of transport such as the rikshaw used as a travelling means in Durban. Travelling by horses and camels is also popular tourist activities, as is cycling, hiking and canoeing. ✓

The Gautrain is another example of a means of travel that has been created that is more environmentally friendly. Previously all tourists had to make use of road vehicles to get to the O.R. Tambo Airport near Johannesburg but now they can make use of the Gautrain and the bus services provided by the Gautrain company. ✓

Tourists can also harm the environment by placing more pressure on natural resources such as water and beaches✓. If numbers of tourists are not controlled a lack of adequate resources may lead to such source becoming depleted or inadequate. ✓ Africa has many arid areas where lack of fresh water may become a problem if there is a too large influx of tourists. This should be kept in mind when attracting visitors to certain areas. ✓

Similarly too many tourists may also put pressure on existing infrastructure. ✓ Sanitation, electricity provision services, road and rails may be inadequate to provide in the additional need created by tourists. ✓ Such services can, however, be updated and increased if it is expected that this will contribute to increasing tourism and then financed from the additional income that is created by the tourism industry. Such improvements in infrastructure will also benefit the local community. ✓

When tourist visit natural and cultural heritage areas care should be taken to ensure that such areas are not negatively affected by the tourists. ✓ Procedures should be in place to ensure that such sites are preserved in pristine order, firstly because it is an issue of national pride✓ and secondly because it will ensure that such sites remain attractive to tourists in the future. ✓ (40)

**Topic 6**

1 Several measures need to be put in place:
- Firstly awareness should be created of the problems related to loss of biodiversity. ✓
- Secondly environmental protection policies should be in place to ensure that such projects are not allowed to proceed. ✓
- Thirdly, research should be done about alternative projects that could be undertaken by such communities that will not deplete natural resources. ✓
- Fourthly, finance and other support measures should be in place to ensure that such alternative projects are encouraged and deemed to be viable. ✓ (4)

2 The Summit's message main message was that a total transformation of our attitudes and behaviour are necessary to save our planet for future✓. Governments agreed that it had become necessary to make eco-efficiency a guiding principle in the design of national plans and policies✓ and that the cost of any action on the environment also had to be taken into account when taking decisions✓. Specific decisions that were taken were the following:

- Patterns of production based on processes that result in toxic waste and pollution had to be reconsidered, e.g. reliance on gasoline for transport✓
- To find alternative sources of energy to replace the use of fossil fuels ✓
- To emphasize more reliance on public transportation systems in order to reduce vehicle emissions, congestion in cities and the health problems caused by polluted air and smog✓
- To create greater awareness of the growing scarcity of water ✓

Although Agenda 21, which was the United Nation's action plan related to sustainable development had been weakened by compromise and negotiation✓, it was still the most comprehensive plan ever sanctioned by the international community✓. If implemented in its entirety it would contribute greatly to ensuring the health future of the planet✓. Two important documents were opened for signature at the summit, namely the *Convention on Biological Diversity*✓ and the *Framework Convention on Climate Change (UNFCCC✓)*. The *Convention on Biological Diversity* is document that legally binds the participating parties to conserve biological diversity✓. The objective of the *UNFCC* was to stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent human induced climate change✓. While the UNFCCC was not in itself a legally binding document it provided for updates (called "protocols") that would set mandatory emission limits✓. The Kyoto protocol is such an update that does bind those countries that had ratified it legally✓.

The Earth Summit influenced all UN conferences that followed in the sense that sustainability of the environment always had to be considered in conjunction with any other goals✓. (16)

3 The reason for this is that the place where emissions occur is not important ✓– it still has the same effect on the atmosphere and therefore on climate change✓. If climate policy is not a global effort measures to decrease emissions in one country will mean that that project will merely be relocated ✓to a more emission-friendly environment✓, thus not resulting in a decrease in global carbon emissions.✓ (6)

4 We have to distinguish between adaptation and mitigation:

- Adaptation refers to practical steps to protect countries and communities✓ from the possible disturbance and damage that may result from effects of climate change✓. For example, if climate change is expected to lead to floods in a certain area, flood walls may be erected and measure should be in place to move human settlements out of flood plains and other low-lying areas. ✓

- Mitigation refers to human actions ✓to reduce the sources of greenhouse gasses ✓and/or increase the sinks that absorb greenhouse gases. ✓ (6)

5 If we do not account for the cost of carbon emissions when we make economic decisions✓, we shall not take the most economically effective decision✓. When we have such a cost that is not accounted for in the economic decision process we call it an *externality*✓. An externality can be both positive and negative ✓but climate change is a negative externality✓. The way to make sure that the externality is also taken into account in the economic decision process is to put a price on it✓. This cost will be determined by the cost of climate change✓. (6)

6 **Introduction✓**

Climate change due to natural phenomena is not a new concept. Recently, however, there is significant evidence that climate change is taking place at a faster pace than it has over the centuries✓, and that it is induced by human action✓. Due to the fast pace of this human induced climate change it becomes very difficult to adapt to it✓.

Therefore when the when the United Nations Framework Convention on Climate Change (UNFCCC) defines climate change they do it as follows:

*a change of climate that is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and that is in addition to natural climate variability observed over comparable time periods (IPCC 2007:2).* ✓✓

Two aspects are important here:

- they refer to changes that are the result of *human activity*✓
- they refer to changes that is in *addition* to the natural changes in climate✓

**Reasons for climate change✓**

One of the most important reasons for human induced climate change is the increase in greenhouse gasses✓. The most important greenhouse gas induced by human activity is *carbon dioxide ($CO_2$)* ✓. Carbon dioxide emissions have been increasing at a faster pace from the 1750s and at a much faster pace over the last 60 years✓.

The most important reasons for the increase in carbon emissions are the following:

- burning of fossil fuels✓
- production of cement✓
- land clearing and forest combustion✓

Plants and trees and the ocean absorb a certain amount of carbon dioxide as part of natural processes✓. However, due to increased human activity that leads to emission of carbon dioxide and a depletion of natural forests, the amount of carbon dioxide that are emitted exceeds the amount that natural processes can absorb✓, and this leads to increased carbon dioxide in the atmosphere and consequently, to climate change✓.

**Results of climate change✓**

Some of the results of climate change due to higher emissions of carbon dioxide are the following:

- *An increase in temperatures worldwide✓:* Eleven of the last twelve years from1995–2006 rank among the 12 warmest years since surface temperature has been recorded (1850). The percentage by which temperatures have been increasing over the last 50 years is nearly double that for the last 100 years. ✓
- *A rise in the level of the ocean✓.* Global average sea level rose at an average rate of 1,8 mm per year from 1961 to 2003. It is highly likely that this is caused by earth warming. This has important implications for low lying areas of the world – some islands may disappear under the ocean. Due to the higher water level seawater also reaches farther inland, and can cause destructive erosion and destroy or change natural habitats of plants and animals. Higher sea levels also mean bigger, more powerful storm surges, as we have seen in recent years✓✓
- *A change in ocean salinity✓.* They observed that surface waters in tropical and subtropical Atlantic Ocean regions became markedly saltier. Simultaneously, much of the water column in the high latitudes of the North and South Atlantic became fresher. This has important implications for marine plants and animals, but also for weather patterns which are affected by currents caused by the differences in salinity in the ocean. ✓✓
- *Higher temperature leads to more extreme weather✓:* More devastating storms, and more severe and prolonged droughts and floods are the result of higher earth temperature. ✓
- *Negative impact on agriculture✓:* Agriculture depends on a predictable climate. If weather patterns become more extreme and unpredictable, it becomes difficult to know when to plant and when to harvest. It also becomes difficult to identify the correct type of crop best suited to a specific area. More drought conditions affect agriculture negatively and a too high temperature affects the growing and pollination of many plants negatively. This effect on agriculture is especially important in developing countries, as poorer communities depend on subsistence agriculture for food and livelihood. ✓✓

**Asymmetry between developing and developed countries✓**

With regards to climate change, an important asymmetry is that the countries that are mostly responsible for climate change✓ are not the countries that will most severely be affected by it✓. The largest emitters of carbon dioxide are developed countries. China, India and South Africa are the exceptions✓. However, both China and India's emissions per capita (i.e. emissions per person) are much lower than that of the countries that lie very high on the human development index✓: emissions per capita in India for 2008 was 1.5 tonnes per person while that it was 17,3 tonnes for the United States and 16,4 for Canada. The size of the population has to be taken into account when interpreting total emissions✓.

South Africa is guilty of high carbon emissions, both in terms of total emissions ✓and in terms of emissions per capita✓. While our emissions per capita is not as high as some of the developed countries, it is higher than that, e.g. of the United

Kingdom. This is due to our high reliance on coal to generate electricity✓. South Africa's emissions (in total and per capita) are much higher than that for the rest of Africa and most other developing countries✓.

**Summary and conclusions✓**
The important conclusions from this discussion of climate change induced by high emissions of carbon dioxide and other greenhouse gasses are thus the following:

- In general, emissions per person in countries that rank higher on the human development index are high, while emissions per person for less developed countries are lower. ✓
- Developing countries will be most severely affected by the results of climate change. ✓
- Developed countries have to decrease their emissions of carbon dioxide. ✓
- Developed countries have to develop in such a way that it does not result in an increase in carbon emissions. ✓

It is therefore necessary to formulate economic policy that will encourage or force humanity to alter their behaviour✓ to try to stop or reverse these climate change trend✓s, and also to ensure that policies and aid is put in place to address the needs of those negatively affected by climate change✓.

*END-OF-YEAR EXAMINATION PAPER*
*MICROECONOMICS*

**Time: 1½ hours**
**Marks: 150**

**Instructions and information:**

- Answer **FOUR QUESTIONS AS FOLLOWS** in your answer book:
  - **SECTION A: COMPULSORY** (30 marks)
  - **SECTION B:** Answer TWO questions (2 × 40 marks)
  - **SECTION C:** Answer any ONE question (40 marks)
- Write the question number above each answer.
- Number the answers correctly according to the numbering system used in this question paper.
- Read the questions carefully and start each question on a NEW page.
- Leave 2–3 lines between subsections of questions.
- Write neatly and legibly.
- Answer only the required number of questions.
- Non-programmable calculators may be used.

**SECTION A (COMPULSORY; ANSWER ALL QUESTIONS)**

**QUESTION 1**

**1.1 Choose the correct answer and write only the letter on your answer sheet.**

1.1.1. Microeconomics is concerned with the behaviour of:
A. B,C and D
B. industries
C. consumers
D. firms.

1.1.2 A person will decide to buy a product when the marginal benefit is greater than the:
A. total cost
B. expected cost
C. marginal cost
D. average cost

1.1.3 The circular flow of goods and money depicts the relationship between:
A. income and money
B. goods and services
C. firms and households
D. wages and salaries

1.1.4 In a command economy, all the economic decisions are taken by:
A. consumers
B. government
C. voters
D. trade unions

1.1.5 Which of the following is a characteristic of oligopolies?
A. A standardised product
B. Many producers
C. Interdependence between a few firms
D. Downward-sloping demand curves faced by firms

1.1.6 If a few companies in the same industry met to set prices and output levels, this is would be an example of:
A. monopolistic behaviour
B. profit-sharing
C. collusion
D. perfect competition.

1.1.7. Which of the following is NOT a characteristic of a perfectly competitive labour market?.
A. Workers appear identical to firms.
B. Workers receive wages that are above their marginal revenue product
C. There are no barriers to entering the labour market.
D. There are no barriers to exiting from the labour market.

1.1.8 If a per-unit subsidy is provided to Jacks Electronics which of the following will happen?
A. Jacks Electronics quantity will increase
B. Jacks Electronics quantity will decrease
C. Jacks Electronics quantity will not change
D. None of the above

(8 × 2 = 16)

**1.2 Choose a description from COLUMN B that matches an item in COLUMN A. Write only the letter (A–H) next to the question number (1.2.1–1.2.8) in the answer book.**

| COLUMN A | COLUMN B |
|---|---|
| 1.2.1 Niche market | A Improves the efficiency of markets by ensuring competition between producers. |
| 1.2.2 Homogeneous product | B Something that originates or exists naturally in a certain cultural area |
| 1.2.3 Indigenous | C A change in total revenue caused by selling one additional unit. |
| 1.2.4 Carbon taxes | D The buyer or seller has no market power to influence the market price of the product. |
| 1.2.5 Market power | E Buyers or sellers are able to influence the market price of a product. |
| 1.2.6 Marginal revenue | F Similar or identical products. |
| 1.2.7 Price-taker | G A specific market within another market. |
| 1.2.8 Competition policy | H A tax on the emission of carbon dioxide gas into the atmosphere. |

(8 × 1 = 8)

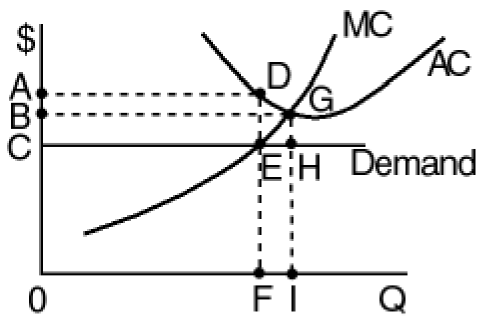
**1.3 Answer only TRUE or FALSE to the statements below on you answer sheet.**

1.3.1 Monopolistic competition exists in many markets.
1.3.2 The output of an industry is the sum of the output of all its individual firms.
1.3.3 Under perfect competition, the factors of production such as labour, capital and entrepreneurship cannot easily move from one geographical area to the next and from one industry to the next.
1.3.4 The variable costs of a firm are costs that can never be changed
1.3.5 Positive externalities are paid for by the person who benefits.
1.3.6 When a firm's MC > MR, it is making normal profit.

(6 × 1 = 6)
**[30]**

**SECTION B (ANSWER ANY TWO QUESTIONS)**

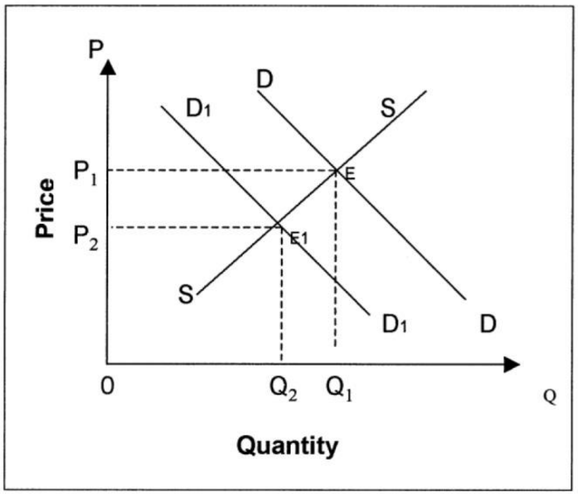
**QUESTION 2 PERFECT COMPETITION**




2.1.1 Which ONE of the above points on the graph is associated with an economic loss? (2)
2.1.2 Define *normal profit*. (4)
2.1.3 Identify the profit maximization point in the Graph (2)

2.2 List SIX characteristics of a perfectly competitive market. (12)

2.3 Use a table to show the differences between a perfect and imperfect market (5 x 2 =10)



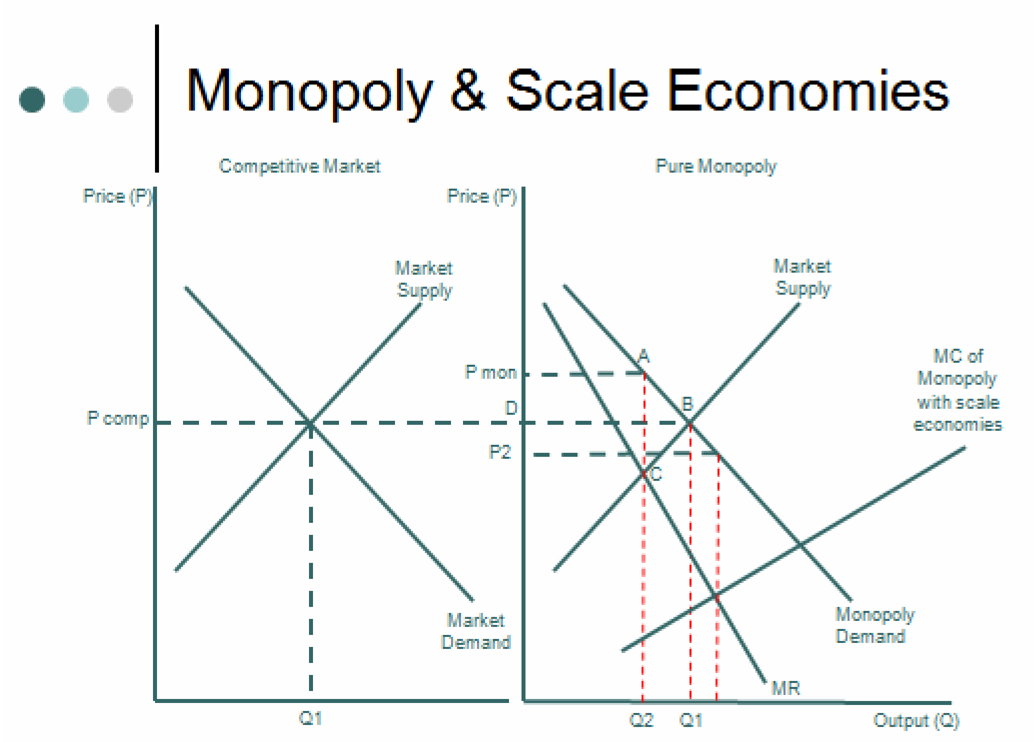

2.4 using the diagram above answer the following questions.

2.4.1. What is the initial equilibrium price? (2)

2.4.2 What is the initial equilibrium quantity? (2)

2.4.3 As a result of the increased demand for cell phones, the demand for land lines has decreased. Which curve represents the new demand for land lines? Substantiate your answer with reference to the diagram. (6) (10) [40]

**QUESTION 3 IMPERFECT MARKETS**




Using the above diagram which indicates both a perfectly competitive market and a monopoly answer the questions that follow.

3.1.1 At what point is profit maximised? (2)

3.1.2 Compared to perfect competition, is the price the firm charges higher, lower or the same? (2)

3.1.3 Compared to perfect competition, is the quantity produced by the firm higher, lower or the same? (2)(6)

3.2. What is meant by the term 'product differentiation'? (2)

3.3 Give two examples of how a company can use product differentiation. (2)

3.4 Briefly discuss the characteristics of a monopoly. (10)

3.5 Discuss the long-run position of a monopolistically competitive firm. (8)

3.5 Discuss any FOUR characteristics of a monopolistically competitive firm. (2 x 4) (8)

[40]

**QUESTION 4 CONTEMPORARY ISSUES**


**[http://www.greenpeace.org.au/blog/?]**

4.1 Choose the correct word from those given in brackets. Write only the word next to the question number (4.1.1 – 4.1.4) in the ANSWER BOOK.

4.1.1 (*Ecotourism/Externality*) means the cost or benefit arising from any activity, which does not affect the person or the organisation carrying on the activity.

4.1.2 When trees are removed on a large scale, (*conservation/deforestation*) takes place.

4.1.3 In an economy with full employment (*the demand for exports/a higher rate of income tax*) will cause inflation.

4.1.4 Most employment in the tourism industry is in the (*transport/hospitality*) sectors.

(4 × 2 = 8)

4.2 Name any TWO indigenous forms of art in South Africa.

(2 × 2 = 4)

4.3 Explain FOUR ways in which tourism benefits the environment.

(4 × 2 = 8)

4.4 Answer these questions

4.4.1 In your opinion, what may stop tourists from choosing to visit an African destination?

(3)

4.4.2 Explain in your own words what the cartoon is saying about environmental awareness.

(2 × 2 = 4)

4.4.3 Do you agree that tourism will lead to a better life for all? Motivate your answer.

(3)

4.5 Discuss five negative effects of globalisation.

(5 × 2 = 10) [40]

**SECTION C (ANSWER ANY ONE QUESTION)**

**QUESTION 5 CONTEMPORARY ISSUES**

'Tourism is an important and rapidly growing sector of the South African economy but it has negative as well as positive consequences.'

Discuss the potential negative and positive impact of tourism on a country.

**Breakdown of marks:**

| | |
|---|---|
| Format | 5 marks |
| Body | 30 marks |
| Interpretation of question | 5 marks |

*FINAL EXAMINATION PAPER*

*MACROECONOMICS*

Time: 1½ hours
Marks: 150

Instructions and information:

- Answer FOUR QUESTIONS AS FOLLOWS in your answer book:
  - SECTION A: COMPULSORY (30 marks)
  - SECTION B: Answer TWO questions (2 × 40 marks)
  - SECTION C: Answer any ONE question (40 marks)
- Make sure your name is on all your answer sheets.
- Write the question number above each answer.
- Number the answers correctly according to the numbering system used in this question paper.
- Read the questions carefully and start each question on a NEW page.
- Leave 2–3 lines between subsections of questions.
- Write neatly and legibly.
- Non-programmable calculators may be used.

SECTION A (COMPULSORY; ANSWER ALL QUESTIONS)

QUESTION 1

1.1 Choose the correct answer and write only the letter on your answer sheet.

1.1.1 A ... has a single monetary system

A. common market

B. customs union

C. economic union

1.1.2 Parastatals are part of the … business sector.

A. commercial

B. private

C. public

1.1.3 When calculating GDP at basic prices, taxes and subsidies on … are taken into account.

A. exports

B. commodities

C. production

1.1.4 Lowering the interest rate can be classified as a … approach to economic growth.

A. supply-side

B. fiscal

C. demand-side

1.1.5 . NEPAD stands for:

A. New partnership for Africa's development

B. New programme for Africa's development

C.. New partnership for Asia's development.

1.1.6. The number of new cars sold is a .... indicator

A. lagging
B. leading
C. coincident

1.1.7 The indicator used to measure gross domestic product, interest rates and unemployment rates is called the ...

A. economic cycle
B. economic indicator
C. leading indicator

1.1.8South Africa benefits directly from tourism because of the increase in tourist ...

A. exports
B. expenditure
C. savings.

(8 × 2 = 16)

1.2 Choose a description from COLUMN B that matches an item in COLUMN A.

Write only the letter (A–H) next to the question number (1.2.1–1.2.8) in the answer book.

| COLUMN A | | COLUMN B | |
|---|---|---|---|
| 1.2.1 | M3 | A | The economic value of the labour force |
| 1.2.2 | World Bank | B | Cash in circulation outside the banking sector plus demand and short, medium and long-term deposits with the bank |
| 1.2.3 | Marginal propensity to consume | C | Evidence relating to or based on experience or observation |
| 1.2.4 | Production price index | D | An international organisation that provides financing, advice and research to developing nations to aid their economic advancement |
| 1.2.5 | Consumer price index | E | The proportion of each additional unit of household income that is used for consumption |
| 1.2.6 | Empirical evidence | F | An inflation index showing the prices of a representative basket of consumer goods and services |
| 1.2.7 | Repo rate | G | The rate of interest that commercial banks pay to borrow money from the Reserve Bank. |

| | | | |
|---|---|---|---|
| 1.2.8 | Human capital | H | Looks at the relative weighting of production inputs and assesses the impact of respective changes in these weightings |

(8 × 1 = 8)

1.3 Read the following statements and answer only TRUE or FALSE on your answer sheet.

1.3.1 Keynesian economists believe that demand should be stimulated to encourage growth.
1.3.2 An increase in gross domestic product (GDP) is an indication of economic growth.
1.3.3 Income distribution in South Africa is fair and equitable.
1.3.4 A decrease in the exchange rate of the rand against the dollar means that the rand is getting stronger.
1.3.5 Bracket creep refers to the situation whereby employees who receive salary increases to keep up with inflation move into higher tax brackets.
1.3.6 Deflation refers to a continuous increase in the general price level over a prolonged period.

(6 × 1 = 6)
[30]

SECTION B (ANSWER ANY TWO QUESTIONS)

QUESTION 2 INTERNATIONAL TRADE

2 .1

2.1.1 Explain TW0 advantages of international trade. ( 2 x 2)

2.1.2 Explain the difference between fixed and managed floating exchange rates. ( 4 x 2 =8)(10)

2.2 List any TWO factors that will influence the demand for a foreign currency, for example the euro.

(2 × 2 = 4)

2.3 Study the information on the South African balance of payments and answer the questions that follow.

BALANCE ON THE CURRENT ACCOUNT

| YEAR | 2006 | 2007 | 2008 |
|---|---|---|---|
| R (billions) | –112,3 | –145,0 | –169,2 |

(Source: *Quarterly Bulletin*, SARB, 2010)

2.3.1 Define the term 'balance of payments'. (2)

2.3.2 What effect has the closing down of textile factories in South Africa had on the balance on the current account of the balance of payments during the three years 2006–2008? Motivate your answer. (4)

2.3.3 What is the trend of the balance on the current account from 2006 to 2008? (2)

2.4 Explain why the government intervenes in the case of demerit goods. (4 × 2 = 8)

2.5 Name the trade protocols that South Africa is a part of to encourage international trade.

(5 × 2 = 10)

[40]

QUESTION 3 ECONOMIC DEVELOPMENT

3.1 Name any two reasons why a geographical area may be underdeveloped. (4)

3.2 Explain what is meant by the term 'IDZ' and its significance. (6)

3.3 Explain why spatial development initiatives that involves more than one country may be beneficial to all countries involved. (4)

3.4 Discuss employment as part of the evaluation of South Africa's economic growth policies.

(5 x 2) (10)

3.5 Explain any TWO major differences between developed countries in the North and the developing countries in the South (North-South divide).

( 2 x 4)(8)

3.6 List any FOUR examples of social benefits provided by government to alleviate poverty. (4 x 2) (8)

[40]

QUESTION 4 INFLATION

4.1 Explain what is meant by the term 'demand-pull inflation'? (6)

4.2 Name the characteristics of stagflation? (2)

4.3 List three measures that can be used to fight cost-push inflation. (6)

4.4 Explain any four effects of inflation. (8)

4.5 Give a definition of inflation. (4)

4.6 Describe any two factors that contribute to demand-pull inflation. (4)

4.7 Look at the cartoon below and answer the questions that follow:


4.7.1 What does the cartoon indicate? (2)

4.7.2 Name any two negative effects of inflation. (4)

4.7.3 What is the relationship between inflation and economic growth? (4)

[40

SECTION C (ANSWER ANY ONE QUESTION)

QUESTION 5

Spatial Development Initiatives (SDIs) and Industrial Development Zones (IDZs) are an integral part as part of South Africa's regional industrial development. Discuss this statement critically, including an explanation of the financial incentives of the state.

Breakdown of marks:

| | |
|---|---|
| Format | 5 marks |
| Body | 30 marks |
| Interpretation of question | 5 marks |

[40]

QUESTION 6

Write an essay explaining in detail how government revenue is raised and how it is allocated.

Breakdown of marks:

| | |
|---|---|
| Format | 5 marks |
| Body | 30 marks |
| Interpretation of question | 5 marks |

[40]

Total: 150 marks

Marking memorandum
Economics examination Paper Microeconomics

Question 1

1.1

1.1.1 A√√

1.1.2 C√√

1.1.3 C√√

1.1.4 B√√

1.1.5 C√√

1.1.6 C√√

1.1.7 B √√

1.1.8 A√√ (16)

1.2

1.2.1 G √

1.2.2 F √

1.2.3 B √

1.2.4H √

1.2.5E √

1.2.6 C √

1.2.7 D √

1.2.8 A√ (8)

1.3

1.3.1T √

1.3.2 T√

1.3.3F√

1.3.4 F√

1.3.5 F√

1.3.6 F√ (6) [30]

Question 2

2.1 2.1.1 D-A because marginal costs are greater than marginal revenue . √√ (2)

2.1.2 Normal profit occurs where marginal revenue equals marginal cost. √√√√ (4)

2.1.3 Point E, where MR = short-run marginal costs. √√ (2)

2.2

a) Many buyers and sellers√√

b) Homogenous product√√

c) Perfect information√√

d) No collusion√√

e) Freedom of entry and exit√√

f) Mobility of the factors of production √√

f) Unregulated market√√ ( 6 x 2)(12)

2.3

| Perfect competition | Imperfect competition |
|---|---|
| Many businesses | One or few businesses |
| Homogeneous product | Heterogeneous or unique |
| Price taker | Price maker |
| No barriers to entry | Some or many barriers to entry |
| Factors of production are freely available. | Factors of production not all freely available. |
| Complete market knowledge on the part of both buyers and sellers | Incomplete market knowledge |
| Collusion s not possible | Control over market or collusion or product |

| | |
|---|---|
| | differentiation. |

(any 5 x 2 =10)

2.4

2.4.1. P1 √√ (2)

2.4.2 Q1 √√ (2)

2.4.3 The demand curve is D2√√ with equilibrium at P2 Q2 . √√This is because the entire demand curve for land lines has shifted backwards because less land lines are demanded at any price level. √√ (6) (10)

[40]

**QUESTION3**

3.1 1 a √√ (2)

3..1.2 Higher √√ (2)

3.1.3 Lower √√ (2)

3.2 A method of encouraging consumers to buy a product rather than other similar products. √√ (2)

3.3 To make the product appear better quality or price, for example no name brands or to give the product a unique branding for example designer jeans and watches. ( any suitable answer) √√ (2)

3.4

- There is only one seller of the product. This single firm is therefore responsible for the output of the industry. √√
- The good or service is unique and there is no close substitutes. √√
- There are barriers to entry. These can be as a result of patents and other forms of intellectual property rights, control over resources, government regulations and decreasing costs. √√
- The monopolist is regarded as a price maker since it is able to influence the market price through changing the quantity it supplies to the market. √√
- It is also possible for the monopolist to make an economic profit in the long run. √√. (10)

3.5 Because entry into the market is fairly easy the economic profit made by the firm will attract other firms to enter the market. √√This will increase the competition the firm faces and changes the demand for the firms product. √√ The demand curve will shift to the left as and therefore the marginal revenue curve as well. Since there are now more substitutes the curve becomes more elastic. √√ This process continues until economic profits are eliminated . √√
(8)

3.6 Relatively many firms and buyers – Under monopolistic competition the number of firms are more than a monopoly (where there is only one), more than an oligopoly (where there are only a few) but less than perfect competition. √√

Firms are price makers. Unlike perfect competition where firms have no influence on the price under monopolistic competition they have some control over the price since they sell a differentiated product. √√

There is no collusion between firms. Due to the large number of firms it is not possible for them to collude to restrict their output and agree on price setting as is the case in oligopoly. √√

There is freedom of entry and exit. Entry into the market is fairly easy since it does not require large capital outlays or access to a scarce natural resources or advanced technology and this increases competition in the market. √√ (2 x 4) (8)

**QUESTION 4**

4.1

4.1.1 Externality √√

4.1.2 Deforestation √√

4.1.3 The demand for exports √√

4.1.4 Transport √√ (4 × 2 = 8)

4.2 Any relevant answer, such as dance, cultural art, fabric designs, souvenirs. √√ √√ (2 × 2 = 4)

4.3 More revenue for use in protecting the environment, √√ greater awareness of need for environmental protection√√more overseas interest in assisting in environmental sustainability, √√skills training for locals in environmental projects. √√ (4 × 2 = 8)

4.4

4.4.1 Political instability, lack of infrastructure, safety concerns – any suitable answer. √√ √(3)

4.4.2 That too little is being done too late (drowning), √√that not enough is being done, √√that voices raising concerns over environmental sustainability are not being heard√√ (2 × 2 = 4)

4.4.3 Yes or no, with any valid reason. √√√ (3)

4.5 Environmental degradation; √√safety and labour regulations are undermined; √√individual governments cannot make their own decisions about their market; √√foreign companies can sue governments for losses; √√job loss and outsourcing; √√free trade leads to globalisation and increased activity by MNCs. √√
(10)

**[40]**

**QUESTION 5**

The New Growth Path identifies tourism as one of the six core pillars of growth. Tourists spend, so an increase in tourism in a certain area will contribute to an increase in income in that area√√
The following types of expenditure resulting from tourism can be identified:

- Direct expenditure: This will involve the expenditure on goods and services by the tourists themselves in hotels, restaurants, shops, other tourist facilities, tourism-generated export, i.e. goods that are purchased by the tourists as well as investment in an area specifically related to tourism, e.g. erection of accommodation facilities at a tourist destination. √√
- Indirect expenditure: This is expenditure by those supplying services and goods to tourists, such as the goods purchased by the hotels and tourist shops. √√
- Induced expenditure: This is the increase in consumer spending that results from the additional personal income generated by the direct √√

For every rand that a tourist spends, there is a multiplier effect, so the total effect on income is much larger. √√

Unemployment is the largest socio-economic problem in South Africa and because tourism is a labour-intensive industry it has the potential to contribute to alleviate unemployment. When foreign tourism expenditure rises, fixed capital formation on average also increases. Tourism contributes a large percentage to total GDP and this contribution is growing. Tourism is therefore an important industry in South Africa. It also indicates that an increase in tourism affects both capital formation and employment, so tourism also contributes to economic development. √√√√

An advantage of the tourism industry is that there are few entry barriers. Entry barriers refer to obstacles that may make it difficult to enter a particular market. The funding requirements can be low, it is not a technology-intensive industry and it does not involve skills that are particularly hard to master. This makes the tourism industry a relatively easy industry to enter, even for people with little educational background. √√√√

Another advantage of tourism is that tourism also contributes to preserving our unique culture and heritage. Tourism, and especially rural and cultural tourism, contributes to preserving our indigenous knowledge systems. √√√√

Tourism also plays an important role in establishing the character of our country and society. If foreign visitors to our country have a pleasant experience, this can contribute to strengthening international relations and building socio-economic and political networks that may benefit us in future. Therefore, investment in tourism is also an investment into the image of our country. A country with a positive image may find it easier to secure foreign investment√√√√

If other countries perceive our country as having a positive image, this will also contribute to national pride. Enhancement of national pride can have a multitude of positive spin-offs such as taking better care of our environment, resources and our communities, including the elderly and the youth. National pride contributes to creation of a hopeful community that works towards the future. √√√√

Tourism has a mostly positive impact on a country, especially from an economic perspective. However, there may be some important negative implications that countries should not overlook and should, ideally, address before the problems become unbearable or unsolvable. √√√√

The first important negative impact that tourism may have is on the environment. In the first place, tourism involves transport, and transport in an important source of pollution. Policy should be in place to ensure that tourists are transported in the most environmentally friendly way, while still preserving their comfort. In many instances, tourists, especially those interested in a more culturally authentic experience, may prefer less comfortable, more environmentally friendly means of transport such as the rickshaw used as a travelling means in Durban. Travelling by horses and camels is also a popular tourist activity, as is cycling, hiking and canoeing. √√√√

Tourists can also harm the environment by placing more pressure on natural resources such as water and beaches. If numbers of tourists are not controlled a lack of adequate resources may lead to such resources becoming depleted or inadequate. Africa has many arid areas where lack of fresh water may become a problem if there is too large an influx of tourists. Countries should keep this in mind when attracting visitors to certain areas. √√√√

Similarly, too many tourists may also put pressure on existing infrastructure. Sanitation, electricity provision services, road and railways may be inadequate to provide for additional tourists' needs. Such services can, however, be updated and increased if it is expected that this will contribute to increasing tourism and then financed from the additional income that is created by the tourism industry. Such improvements in infrastructure will also benefit the local community. √√√√

When tourists visit natural and cultural heritage areas, care should be taken to ensure that they do not affect such areas negatively. Procedures should be in place to ensure that such sites are preserved in pristine order, firstly because it is an issue of national pride and secondly because it will ensure that such sites remain attractive to tourists in the future. √√

**Breakdown of marks:**

| | |
|---|---|
| Format | 5 marks |
| Body | 30 marks |

Interpretation of question 5 marks

**[40]**

**QUESTION 6**

Climate change policy:

Climate change is a global problem that must be addressed. The origin of emissions occur is not important – it still has the same effect on the atmosphere and therefore on climate change. √√

The United Nations Framework Convention on Climate Change (UNFCCC) is the arrangement that oversees global climate policy. √√

In 1992, countries joined this international treaty to decide what could be done to limit average global temperature increases and the resulting climate change, and to decide how best to address the consequences, many of which were, by that time, already inevitable. √√

The steps that were formulated to form part of the Convention are the following:

- Recognises that there was a problem using scientific evidence.
- Sets a specific goal for the decrease in carbon emissions and other greenhouse gasses.
- Puts the onus on developed countries to lead the way.
- Directs new funds to climate change activities in developing countries.
- **Keeps tabs on the problem and on what is being done about it by expecting countries to report on progress.**
- Charts the beginnings of a path to strike a delicate balance to ensure that development is not hindered by limiting emissions.

Recognises that adaptation to climate change is also an important issue. √√√√ √√

By 1995, countries realised that emission reduction provisions in the Convention were inadequate and negotiations started to improve the global response to climate change. In 1997 the Kyoto Protocol was adopted. √√

The Kyoto Protocol legally binds developed countries to emission reduction targets. The Protocol's first commitment period started in 2008 and ended in 2012. √√

At COP17 in Durban, governments of the Parties to the Kyoto Protocol decided that a second commitment period, from 2013 onwards, would seamlessly follow the end of the first commitment period. The length of the second commitment period was to be determined: it would be either five or eight years long. √√√√

There are now 195 Parties to the Convention. √√

Reaction to climate change rests on two pillars: adaption and mitigation. √√

Adaptation refers to practical steps to protect countries and communities from the possible disturbance and damage that may result from effects of climate change. For example, if climate change is expected to lead to floods in a certain area, flood walls may be erected and measures should be put in place to move human settlements out of floodplains and other low-lying areas. √√

Mitigation refers to human actions to reduce the sources of greenhouse gasses and/or increase the sinks that absorb greenhouse gases. √√

The UNFCCC has several action plans in place to encourage adaptation in developing countries that may be mostly vulnerable to the results of climate change. These include the Cancun Adaptation Framework and the Nairobi Work Programme. √√√√

We must account for the cost of climate change when we make economic decisions, otherwise we will not make the most economically effective decisions. When we have a cost that is not accounted for in the economic decision-making process, we call it an externality. An externality can be positive or negative but climate change is a negative externality. The way to make sure that the externality is also taken into account in the economic decision process is to put a price on it. This cost will be determined by the cost of climate change. Often this cost will take the form of a tax. √√ √√

In South Africa, we have a carbon tax. From the beginning of September 2010, the introduction of a carbon emissions tax or levy on all new motor cars was introduced. This tax is paid on the extra amount of carbon emissions emitted by the vehicle. √√ √√

This means that the cost of the higher emissions will be taken into account when deciding on the car best suited to your needs and budget. √√ Similar taxes may be also raised on any activity that results in carbon emissions. √√

An alternative to carbon tax is the cap-and-trade system. √√ Under this system carbon credits are allocated to companies. √√ Each credit will allow a company to emit a certain amount of carbon. This allocation can take place in the form of an auction where the companies bid for the amount of credits that they require, or through a process called grandfathering where companies receive a certain amount of credits based on their previous emissions. At the end of a certain period, if their carbon emissions fall short of the carbon credits that they own, a company can sell the extra credits in the carbon credit market. √√

Countries that are party to the Kyoto Protocol and have ratified this protocol will use measures such as the ones that Nordhaus (2009) summarises. The following describes the mechanisms through which putting a price on carbon emissions leads to a decrease in such emissions: √√
It provides a signal to consumers about what goods and services produce high carbon emissions and should therefore be used more sparingly. √√
It provides signals to producers about which inputs (such as electricity from coal) that use more carbon, and those (such as electricity from wind) that use less or none. So, it creates an incentive to use low-carbon technologies. √√

Inventors and innovators will be induced to develop and introduce low-carbon products and processes to replace carbon-intensive technologies, due to the higher cost of carbon. √√
Measures that put a price of carbon mean that those economic participants who wish to act ethically do not have to engage in a costly information gathering process to determine the processes that result in the fewest carbon emissions. √√

- **Breakdown of marks:**

| | |
|---|---|
| Format | 5 marks |
| Body | 30 marks |
| Interpretation of question | 5 marks |

**[40]**

TOTAL MARKS 150

**ECONOMICS GRADE 12 MACRO ECONOMICS MEMO**

QUESTION 1

1.1

1.1.1B √√

1.1.2 C √√

1.1.3 B √√

1.1.4 C √√

1.1.5 A√√

1.1.6 B√√

1.1.7 B √√

1.1.8 B √√ (16)

1.2

1.2.1 B √

1.2.2 D√

1.2.3 E√

1.2.4 H√

1.2.5 F√

1.2.6 C√

1.2.7 G √

1.2.8 A √ (8)

1.3

1.3.1 T√

1.3.2 T√

1.3.3 F√

1.3.4F√

1.3.5T√

1.3.6F √ (6) (30)

QUESTION 2

2.1.1 Improves Global Efficiency. √√ Specialisation. √√ Economies of scale. √√ Innovation. √√ Choice. √√Lower Prices. √√ Spreads Democratic Values. √√ (2 x 2)

2.1.2 In a fixed exchange rate the value of the currency is fixed, usually again the US dollar. When a country wants to adjust a fixed exchange rate it must devalue or revalue the currency. √√√√In a floating exchange system the currency is treated as any other market and allowed to find its own level by supply and demand. √√√√
( 4 x 2 = 8)

2.2 Increased imports, √√ repayment of loans to Europe, √√tourists visiting Europe, √√businessmen visiting Europe. √√ (2 x 2) (4)

2.3.1 The balance of payments is a record of all of a country's transactions with the rest of the world over a period of time. √√ (2)
2.3.2 South Africa now imports textiles which has a negative effect on the current account of the balance of payments because we must purchase more foreign currency to pay for them. √√√√ (2x2) (4)
2.3.3 Imports have been increasing causing a negative balance to increase. √√ (2)(8)

2.4 Because they are not considered good for us, therefore the government intervenes to discourage their use by using laws and taxes, an example is cigarette smoking or drugs. √√√√ (4 x 2) (8)

2.5 The Southern African Customs Union (SACU) The SACU consists of South Africa, Botswana, Lesotho, Namibia and Swaziland. These countries jointly negotiate free trade areas with other countries. √√

The Southern African Development Community (SADC) The SADC is a free trade area and its member countries are interested in forming an economic and monetary union. √√

The African Union (AU) The AU exists to promote cooperation between the countries of Africa. Its economic development programme, called the New Partnership for Africa's Development (NEPAD) encourages regional cooperation and integration. The AU would like all African countries to join together to form an economic and monetary union. √√

The European Union (EU) The EU-SA free trade agreement encourages increased trade between the two signatories. SA has agreed to certain targets concerning reduced tariffs on goods traded between itself and the EU. √√

Mercusor is a regional trade area (RTA) consisting of Brazil, Argentina, Paraguay and Uruguay. In 2000 SA agreed to work towards a free trade agreement between SACU and Mercusor. √√

SA has an agreement with the European Free Trade Area (EFTA) which includes Norway, Switzerland, Iceland and Liechtenstein. √√

In 2010 South Africa and China signed trade contracts worth R2, 3 billion.

SA is also in the process of concluding negotiations with India regarding a free trade agreement. √√

South Africa has recently become part of this group which is now referred to as the BRICS. (Brazil, Russia, India, China and South Africa) √√ (any 5 X 2 =10)
[40]

QUESTION 3

3.1 Physical or geological reasons, such as presence or absence of fertile land, water, minerals, management of natural resources. √√ Conflict, e.g. between political or religious groups in a country. √√
Availability of and access to infrastructure. √√

(2 × 2 = 4)

3.2 An Industrial Development Zone (IDZ) is a clearly delineated industrial estate or area that constitutes a free trade enclave in the customs and trade regime of a country, √√ and where foreign manufacturing firms produce mainly for export, √√ and benefit from fiscal and financial incentives. √√The advantage of an IDZ is that it attracts investment, including foreign investment, and leads to job creation.√√The IDZs, which are all based near ports and airports, focus mainly on export industries. √√

(3 × 2 = 6)

3.3 Economic integration could yield greater developmental benefits √√by the collective use of economic policies.√√Working together can be much more effective and efficient √√and a project that may not be viable for one country or region to undertake may become viable through cooperation√√

(2 × 2 = 4)

3.4 Full employment is a major economic objective, this means employment for all economically active persons willing to work. √√ Regional development includes programmes such as IDZ's, SDI's, incentives, BBSDP and strategic investment programmes. √√ The national Skills Authority aims to assist in facilities for skills training to improve the quality of labour. √√The RDP, GEAR and ASGSA are broad national economic programmes aimed at creating a platform for economic growth which will increase employment opportunities. √√ (4 x 2) (8)

3.5 Standard of living, √√ employment and education opportunities, √√ poverty levels, level of economic development. √√

3.6 Healthcare, √√grants to the elderly, √√ education, √√ primary healthcare. √√ (4 x 2) (8) [40]

QUESTION 4

4.1 Demand-pull inflation happens when total demand for goods and services exceeds total supply. √√ It is also known as excess-demand inflation. √√ We also say that demand-pull inflation occurs when aggregate spending in the economy is continuously exceeding the increase in supply of goods and services. √√ Demand is pulling up prices. √√

(6)

4.2 Inflation coupled with unemployment and economic stagnation. √√

(2)

4.3 Pay rise freezes√√ Price freezes √√ Increased cost of borrowing√√ Tightening of credit controls√√
(any 3 × 2 = 6)

4.4 Inflation benefits debtors (borrowers) at the expense of creditors (lenders) by redistributing wealth from debtors to borrowers. √√
People dependent on savings and fixed income are particularly vulnerable to this distribution effect of inflation. √√
Inflation also redistributes income from the private sector to the government because governments are usually debtors. √√ Exports become less competitive due to higher prices. √√

(4 × 2 = 8)

4.5 Inflation is a sustained increase in the general price levels √√ over a period of time√√
(4)

4.6 Increased spending by households. This might be due to easier access to credit or lower interest rates that make credit cheaper. With credit being cheaper, households will borrow more, and therefore spend more. √√
Increased investment spending by firms. This might be the result of a higher demand for goods and services produced by them, a lower interest rate that decreases the cost of borrowing, or increased business confidence. √√
Increased spending by government. This can be the result of policies to deal with unemployment or that provide more services to the public.√√
Increased spending by the foreign sector. This can be the result of a higher demand for exports due to higher economic growth rates in our trading partners or a decrease in the price of minerals, which increases the quantity demanded. √√
(any 2 × 2 = 4)

4.7 4.7.1 The growth of inflation at the expense of the economy√√

(2)

4.7.2 Borrowing increases, fixed incomes and pensions are reduced, increased

4.7.3 As price levels rise, the real value of economic growth decreases. There is an inverse relationship between inflation and economic growth. √√√√ (2 ×

**[40]**

QUESTION 5

1. IDZ stands for industrial development zone. IDZ's are geographically designed, purpose-built industrial sites which provide services tailored for export-orientated industries.√√ They are physically enclosed and linked to an international port or airport.√√ They are designed to attract new investment in export-driven industries. √√ They fall outside domestic customs zones and able to import items free of customs and trade restrictions, add value, and then export their goods. √√ development and management done by private sector. √√ The government IDZ policy is designed to boost exports and jobs. √√IDZ's aim to encourage economic growth and attract foreign investment

in industrial development√√ and facilitate international competitiveness regarding manufacturing. √√ (max 10)

2. Spatial Development Initiative programmes attract infrastructure and business investments to underdeveloped areas with the primary aim of creating employment √√ The Department of Trade and Industry is the driving force behind industrial and spatial development √√ and the DTI makes plans together with the central, provincial and local government, IDC, parastatals and research institutions. √√ The Industrial Development Policy Programme (Spatial Development) has 2 main focus points: - spatial development initiative (SDI) and financial incentives.√√ SDI refers to national government initiative programme aimed at unlocking inherent and underutilised economic development potential of certain specific spatial locations in SA. √√

Some of the main focus points of the SDI Programme are: Lubombo Corridor (agro-tourism, education, craft, commercial and agricultural sectors); √√ KwaZulu-Natal (ports of Durban and Richards Bay); West Coast SDI (fishing and industrial ports); √√ Coast-2-Coast Corridor with agro-tourism. √√ (max 10)

3. Financial incentives: Small and Medium Enterprise Development Programme (SMEDP) √√ an incentive that provides a tax-free cash grant for investment in industries in South Africa√√ E.g. manufacturing, agricultural, processing, aquaculture and tourism. √√ Critical Infrastructure Fund Programme (CIF) √√ a tax-free cash grant incentive for projects that are designed to improve critical infrastructure in South Africa√√ e.g. for installation, construction of infrastructure, payment of employees, materials directly consumed during installation. √√ Duty-free Incentives (for businesses operating in the IDZs) aimed at export orientated manufacturing to enhance competitiveness√√ and promote foreign and local direct investment. √√Foreign Investment Grant a cash grant to assist foreign investors who invest in new manufacturing businesses in SA √√ Qualifying cost of relocating
new machinery and equipment from abroad. √√ Strategic Investment Projects (SIP) attract investment from local and foreign entrepreneurs with the following industry sectors: manufacturing, computer,
research and engineering. √√ Skills Support Programme (SSP) cash grant for skills development encourage greater investment in training in general and stimulate development
of new advanced skills. √√ Black Businesses Supplier Development Programme (BBSDP) incentive consist of 80% cash grant provides black-owned enterprises with access to
training to improve management effectiveness of their enterprises. √√ (max 15)

Format - 5 marks
Body - 30 marks
Interpretation of question - 5 marks as per grid [40]

QUESTION 6

The budget is a plan for raising and spending the money from the people of the country by the government for the public benefit. √√ The people of South Africa are represented by Parliament and the Constitution, which sets guidelines for estimating, allocating and monitoring the budget. √√

The government uses income that it receives from taxation, state run enterprise and loans to pay for its expenditure on social services, economic growth and government worker salaries amongst other things. √√√√ In February of each year the Minister of Finance sets out his plans for how he will raise and spend money for the coming year in the Budget**.** √√

The medium term expenditure framework. This is published each year, a few months before Budget Day. √√ It contains a summary of government's goals and objectives, information about how the government expects the economy to perform over the next three years how much tax is expected to be collected and levels of government spending and government deficit. √√It also contains an explanation of the way revenue will be shared between national, provincial and local government and a summary of the policies upon which the MTEF is based. √√The main objectives in publishing such a document ahead of the actual budget are to improve transparency and to allow time for debate. √√

The main budget. This is the budget of the central government and it is presented during the second half of February. √√ It is presented to parliament by the minister of finance in order to get their approval. This budget is for one fiscal year which runs from 1 April to 31 March. √√After the **top slice** has been allocated, the governments' revenue is divided up among the national, provincial and local spheres. √√ The provinces receive the largest portion of this revenue as they perform most of their functions on behalf of central government. √√

Taxation is the main revenue of the government as well as income from property and investments and loans. √√√√√√ taxation can be both direct, as in income tax and indirect as in VAT. Revenue is allocated on an equitable basis, according to population size, to provincial governments (43.5%) and local municipalities. (1.1%) The top slice (23%) is used for debt repayment and emergencies. 43.3 % is retained by national government for nationally provided services such as the armed forces. √√√√√√√

(14)[40]

Format - 5 marks
Body - 30 marks
Interpretation of question - 5 marks as

TOTAL 150