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Possible Essays

Economics

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Grade 12



SURNAME: _____ NAME: _____

TEACHER: _____ YEAR: _____

SCHOOL: _____

THE
DISTINCTION
BOUND STUDENT



24 essays were identified for the next 3 year cycle (2017 – 2019) as follows:

Paper 1	Paper 2
❖ Macroeconomics: 6 essays ❖ Economic Pursuits: 6 essays	❖ Microeconomics: 6 essays ❖ Contemporary Economic Issues of the day: 6 essays

Paper 1 Possible Essays:

Macroeconomics:

Circular flow Possible Essays

1. Discuss in detail the markets within the FOUR-SECTOR model:
Factor markets: (labour, resource, capital) - Product markets: (consumer and capital goods, durable, semi-durable and non-durable) - Financial (monetary and capital) - Foreign exchange market - Link the operation of financial and foreign exchange markets to the participants of the circular flow

Business Cycles Possible Essays

2. Discuss in detail 'The new economic paradigm'/Explain the 'smoothing of cycles'
Explain demand-side policies. *[Explain clearly how monetary and fiscal policies (expansionary and contractionary) can be used in smoothing out business cycles - Relate to inflation (peak) and unemployment (trough) by using the Phillips curve]*
Explain supply-side policies and how aggregate supply can be stimulated through: *[Reduction in costs - Improving efficiency in inputs - Improving efficiency in markets]*
3. Discuss in detail the features underpinning forecasting:
Indicators *[Leading - Coincidence - Lagging - Composite]* Length of a cycle - Amplitude - The trend line - Extrapolation - Moving averages

Public Sector Possible Essays

4. Discuss in detail how each of the following factors contributes to poor public sector provisioning:
Accountability - Efficiency - Assessing needs - Pricing policy - Parastatals – Privatisation / Nationalisation
5. Discuss in detail the main objectives of the public sector in the economy
Economic growth - Full employment - Exchange rate stability - Price stability - Economic equity

International Trade Possible Essays

[NO ESSAYS were identified for the next three-year cycle.]

Protectionism and Free Trade Possible Essays

6. Discuss in detail export promotion and import substitution:
Definition - Methods – Reasons / Advantages - Disadvantages

Economics Pursuits:

Economic Growth and Development Possible Essays

7. Discuss in detail the demand-side approach in promoting growth and development in South Africa
Give an overview of the demand-side approach: *[The monetary policy (interest rate changes, open market transactions, moral suasion) - The fiscal policy (progressive personal income tax, wealth tax, cash benefits, natural benefits, other redistribution, land restitution and redistribution, subsidies on property)]*
8. Discuss in detail the supply-side approach in promoting growth and development in South Africa
Give an overview of the supply-side approach: *[Efficiency and effectiveness of markets - Business efficiency - The cost of doing business - The factors of production (natural resources, human resources, capital, entrepreneurship, technology)]*

Industrial Development Policies Possible Essays

9. Discuss in detail South Africa's initiatives (endeavours) in regional development
10. Discuss in detail regional development in South Africa in terms of the following benchmark criteria
Free market orientation - Competitiveness - Sustainability - Good governance - Provisioning of resources - Investment of social capital - Integration - Partnerships

Economic and Social Performance Indicators Possible Essays

11. Discuss in detail the following economic indicators:
*Production indicators [*Nominal GDP - Real GDP - Per capita GDP*] - Inflation rate indicators [*Production prices (PPI) - Consumer prices (CPI)*] - Foreign trade indicators [*Terms of trade - The exchange rate*] - Employment indicators [*Economically active population (EAP) - Employment rate - Unemployment rate*] - Productivity indicators [*Labour productivity - Remuneration per worker*] - Interest rate indicators [*Repo rate*] - Money supply indicators [*M1 - M2 - M3*]
12. Discuss in detail the following social indicators:
Demographic indicators [*Population growth - Life expectancy*] - Nutrition and health indicators: Nutrition [*Malnutrition – Obesity*] Health [*Child mortality - Under 5 mortality - Spending on health - Access to clean water - Access to sanitation*] - Education [*Percentage public-sector spending - Percentage enrolment in secondary schools*] - Services [*Electricity - Refuse/Garbage removal - Water supply – Sanitation*] - Housing and urbanisation: Housing [*Number of houses completed*] Urbanisation [*Natural growth in population - Migration - Founding of new towns*]

Paper 2 Possible Essays:

Microeconomics:

Dynamics of Perfect Markets Possible Essays

13. Compare and contrast the FOUR broad types of market structures (perfect competition, monopolistic competition, oligopoly and monopoly) in detail in terms of the following.
Number of businesses - Nature of product - Entrance - Control over prices - Information - Examples - Demand curve - Economic profit/loss - Decision-making - Collusion - Productive/Technical efficiency - Allocative efficiency
14. Examine in detail the various equilibrium positions with the aid of graphs.
Explain economic profit, economic loss, normal profit with the aid of graphs (short run) - Explain normal profit with the aid of a graph (long run) - Explain shutdown point using costs and revenue (FC, VC, TC, TR) and explain graphically (AR and AVC)

Dynamics of Imperfect Markets Possible Essays

15. Discuss the monopoly in detail
16. Examine the oligopoly in detail

Market Failure Possible Essays

17. Discuss in detail how the following factors leading to the misallocation of resources in the market:
Externalities - Missing markets - Imperfect competition - Lack of information - Immobility of factors of production - Imperfect distribution of income and wealth
18. Discuss in detail state intervention as a consequence of market failures, with the aid of relevant graphs
Direct control - Imperfect markets - Minimum wages - Maximum prices - Minimum prices - Taxes and subsidies - Subsidies on goods and services - Redistribution of wealth - Government involvement in production

Contemporary economic issues of the day Essays:

Inflation Possible Essays

19. Discuss in detail the causes of demand-pull inflation:
Increase in household consumption [*Decline in savings* - *Tax reduction* - *Access to credit*] - Investors' expenditure - Government expenditure - Export services
20. Discuss in detail the causes of cost-push inflation
Wages - Key inputs - Exchange rate depreciation - Profit margins - Productivity - Natural disasters

Tourism Possible Essays

21. Examine in detail the effects of tourism
GDP - Employment - Poverty - Externalities - Environment – Investment
22. Examine in detail the benefits of tourism
Households - Businesses - State - Infrastructure development

Environmental Sustainability Possible Essays

23. Discuss in detail how the government can ensure sustainable development under the following headings:
Grant property rights - Pay for environmental use - Levy environmental tax - Pay environmental subsidies - Issue marketable permits - Command and control - Voluntary agreements – Education
24. Discuss in detail the following problems and the international measures taken to ensure sustainable development under the following headings:
Biodiversity - Chemical waste - Hazardous waste - Climate change policy – adaptation and mitigation - Indigenous knowledge

TOPIC:

CIRCULAR FLOW:

1. Discuss in detail the markets within the FOUR-SECTOR model:

Factor markets: (labour, resource, capital) - Product markets: (consumer and capital goods, durable, semi-durable and non-durable) - Financial (monetary and capital) - Foreign exchange market - Link the operation of financial and foreign exchange markets to the participants of the circular flow

Introduction:

A market is any mechanism that brings together buyers and sellers of a good or service in order to determine the **price** and **quantity** of goods or services that are going to be exchanged.

Product / goods market

- ❖ Goods and services are traded on the product market.
- ❖ Households, government and the foreign sector purchase these goods and services from firms on this market.
- ❖ Services are **non-tangible** actions that satisfy people's needs and wants.
- ❖ Examples are services offered by accountants, teachers, doctors, drivers, etc.
- ❖ The forces of **supply** and **demand** determine the **equilibrium price** and **quantity**.
- ❖ Goods are tangible items and they include consumer goods, capital goods, durable, semi-durable and non-durable goods.
- ❖ Households purchase consumer goods for consumption and businesses purchase capital goods for use in the production process.
- ❖ **Consumer Goods:**
 - ✚ Consumer goods are products that are purchased for consumption by consumers to satisfy their needs and wants.
 - ✚ They are alternatively called final goods because they are the end result of production and manufacturing and are what a consumer will see on shelves in stores.
 - ✚ Examples include food, clothes, etc.
- ❖ **Capital Goods:**
 - ✚ Goods that are not produced for their own sake but to produce other goods, e.g. machinery
 - ✚ Capital goods open a pathway to increased efficiency and productive capacity, facilitating improved services, as well as new incomes and employment for firms and households.
 - ✚ The act of purchasing capital goods is called investment or capital formation, which is denoted by the symbol I.
- ❖ **Non-durable goods** are goods that cannot be re-used, e.g. an apple.
- ❖ **Semi-durable goods** only last for a short period of time but can be used more than once, e.g. chalk.
- ❖ **Durable goods** can last for more than a year because they do not wear out easily, e.g. a chalk-board.

Factor / Resources Market

- ❖ The four **factors of production** (land, labour, capital and entrepreneurship) are traded for income in form of wages/salaries, interest, economic rent and profit on this market.
- ❖ The price and quantity traded is also determined by the interaction of **demand** and **supply**.
- ❖ **Land:**
 - ✚ Land comprises all naturally occurring resources whose supply is inherently fixed.
 - ✚ Natural resources are fundamental to the production of all goods, including capital goods.
 - ✚ Thus, 'Land' includes all things that are not made by man
 - ✚ The remuneration for land is **economic rent**.
- ❖ **Labour:**
 - ✚ Labour is a measure of the work done by human beings.

- ✚ In other words, it is the human input in the production process.
- ✚ The remuneration received for the supply of labour by households is **wages and salaries**.
- ✚ Wages are received hourly, weekly, biweekly, etc. while salaries are received monthly.
- ❖ **Capital:**
 - ✚ Capital is the man made physical goods used to produce other goods and services.
 - ✚ Remuneration received for capital is called **interest**
- ❖ **Entrepreneurship:**
 - ✚ Entrepreneurship is the process of bringing the other factors of production together in order to produce a product or service.
 - ✚ The remuneration for entrepreneurship is **profit**

Financial market

- ❖ The financial market consists of banks, pension funds, insurance companies, and the JSE.
- ❖ Funds from **surplus units** are channelled to **deficit units** in the economy.
- ❖ Surplus units are those firms and households in the economy that **do not spend all their income**.
- ❖ They are called the **savers** in the economy.
- ❖ Savers deposit their **surplus funds** into financial institutions.
- ❖ The institutions then use this money to **lend to deficit units** (borrowers).
- ❖ Deficit units are those households, firms and government in an economy that are **looking for more funds**. They are called the **borrowers** in an economy.

Money market

- ❖ This is used by participants as a means for borrowing and lending in **short term**, from a few days to **just less than a 3 years**.
- ❖ In short, it is a market for **short-term savings and loans**.
- ❖ The SARB is a key institution in the money market.
- ❖ Kinds of securities that change hands in this market are:
 - ✚ Treasury bills
 - ✚ Reserve bank debentures
 - ✚ Banker's acceptances
 - ✚ Short-term government bonds
 - ✚ Short-term company debentures

Capital market

- ❖ It is a financial market in which individuals and institutions trade financial securities in the **long-term**, which is **3 years and above**.
- ❖ In short, it is long-term deposits and borrowings (e.g. mortgage bonds)
- ❖ The **Johannesburg Securities (Stock) Exchange (JSE)** is a key institution in the capital market.

The foreign exchange market

- ❖ In an open economy, **foreign currency** is needed to facilitate transactions between countries.
- ❖ It is on this market that **one currency** can be **exchanged into another** (e.g. Rand for Pound)
- ❖ The amount that is received on exchange depends on the **exchange rate**.
- ❖ The exchange rate is usually determined by the interaction of **demand** and **supply**. At times the central bank influences exchange rates **directly** or **indirectly**.
- ❖ You can get hold of foreign currency through any **commercial bank** in South Africa e.g. FNB, ABSA, Nedbank and Standard bank.

TOPIC:

BUSINESS CYCLES

2. Discuss in detail 'The new economic paradigm'/Explain the 'smoothing of cycles'

Explain demand-side policies. *[Explain clearly how monetary and fiscal policies (expansionary and contractionary) can be used in smoothing out business cycles - Relate to inflation (peak) and unemployment (trough) by using the Phillips curve]*

Explain supply-side policies and how aggregate supply can be stimulated through: *[Reduction in costs - Improving efficiency in inputs - Improving efficiency in markets]*

The new economic paradigm

- ❖ In the new economic paradigm (way of thinking), government focuses less on **fine-tuning** and more on **eliminating uncertainties** with regard to **fiscal** and **monetary policies**.
- ❖ The government can increase output by combining demand-side and supply-side policies.

Demand-side policies

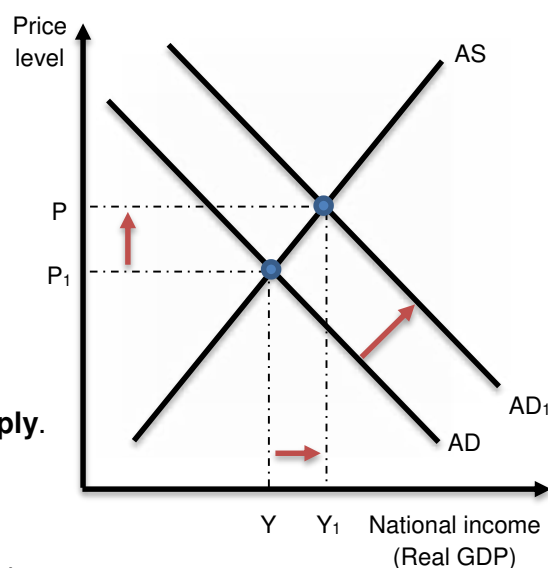
- ❖ Demand side policies aim to increase aggregate demand.
- ❖ This needs to be done during a recession or a period of below trend growth.
- ❖ If there is spare capacity (negative output gap) then demand side policies can play a role in increasing the rate of economic growth.
- ❖ However, if the economy is already close to full capacity (trend rate of growth) a further increase in AD will mainly cause inflation.
- ❖ These monetary and fiscal policies are implemented with the aim of increasing aggregate demand on the output produced by domestic firms in order to stimulate economic growth.

Monetary policy (executed by the SARB Governor)❖ **Expansionary monetary policy:**

- ✚ This policy is traditionally used to try to combat unemployment in a recession by **lowering interest rates** in the hope that cheap credit will entice businesses into expanding and **increasing money supply**.
- ✚ This activity by the Reserve Bank will increase demand for goods and services.

❖ **Restrictive monetary policy**

This policy is intended to slow inflation in order to avoid the resulting distortions and deterioration of asset values by **increasing interest rate** and **reducing money supply**.

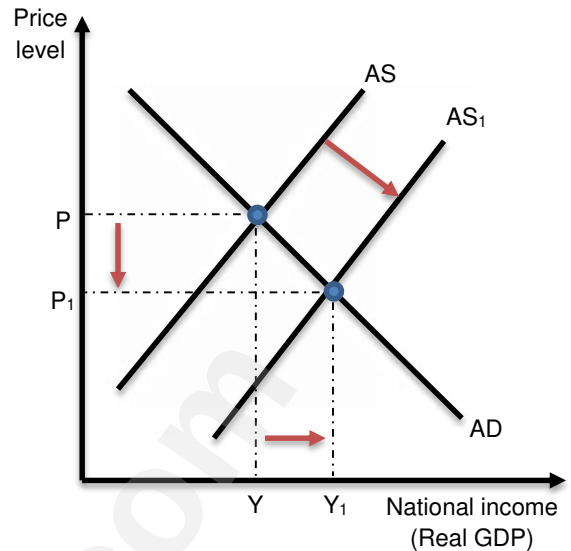
**Fiscal policy (executed by the Minister of Finance)**

- ❖ During an upswing, the minister of finance can use the **restrictive fiscal policy**, and the government does this by **increasing taxation** (leakage) and **decreasing expenditure** (injection) so as to curb inflation.
- ❖ During a downswing, government can use the **expansionary fiscal policy**, which is increasing expenditure (injection) and decreasing taxation (leakage).

Supply-side policy

Supply-side policies include the following:

- ❖ Increase the efficiency of markets to make them more competitive:
 - + **Deregulation:** reduce government intervention
 - + **Competition:** Encourage competition by implementing and monitoring the Competition Act. This can also be achieved by encouraging and supporting entrepreneurship.
 - + **Privatisation:** this helps increase competition.
- ❖ Decrease in **production cost**:
 - + Subsidies to reduce production cost
 - + Decrease administrative costs (red tape)
- ❖ Increase the **efficiency of inputs**:
 - + Decrease tax rates
 - + Encourage firms to use modern technology
 - + Improve the quality of human resources through the skills development act
 - + Provide free advisory services

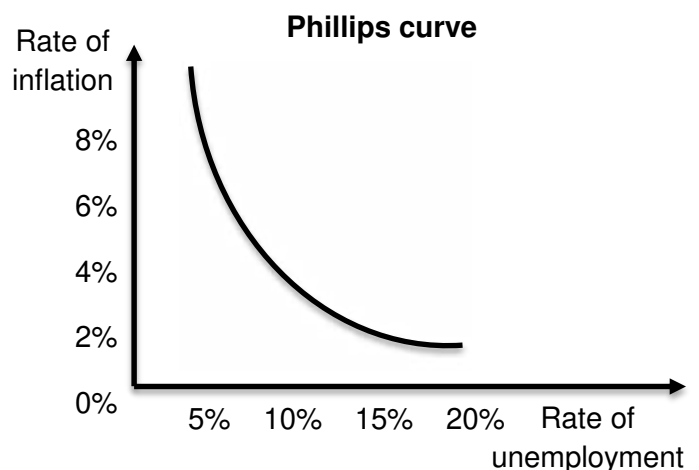


The effects of demand-side and supply-side policies:

- ❖ **Inflation:** the policies can cause output to increase without causing prices to go up.
- ❖ **Supply is often sticky and fixed in short term:** supply side measures makes supply more flexible
- ❖ **Unemployment:** demand-side policies increases demand for labour, which reduces unemployment.

The Phillips Curve:

- ❖ The Phillips curve represents the relationship between the rate of inflation and the unemployment rate.
- ❖ The curve suggested that changes in the level of unemployment have a direct and predictable effect on the level of price inflation.
- ❖ This suggests policy makers have a choice between prioritising inflation or unemployment.
- ❖ During the 1950s and 1960s, Phillips curve analysis, suggested there was a trade-off and policy makers could use demand management (fiscal and monetary policy) to try and influence the rate of economic growth and inflation.
- ❖ For example, if unemployment was high (20%) and inflation low (2%), policy makers could stimulate aggregate demand.
- ❖ This would help to reduce unemployment (say to 5%), but cause a higher rate of inflation (8%).
- ❖ The accepted explanation during the 1960's was that a fiscal stimulus, and increase in AD, would trigger the following sequence of responses:
 - + An increase in the demand for labour as government spending generates growth.
 - + The pool of unemployed will fall.
 - + Firms must compete for fewer workers by raising nominal wages.
 - + Workers have greater bargaining power to seek out increases in nominal wages.
 - + Wage costs will rise.
 - + This would lead to cost push inflation.



TOPIC:

BUSINESS CYCLES

3. Discuss in detail the features underpinning forecasting:

Indicators [*Leading - Coincidence - Lagging - Composite*] Length of a cycle - Amplitude - The trend line - Extrapolation - Moving averages

Economic indicators used for forecasting

- ❖ An economic indicator is **statistic** about **economic activity**, usually of macroeconomic scale.
- ❖ They are used to interpret the overall health of the economy either current or the future.
- ❖ They show the **way / direction** in which the economy is moving.
- ❖ These indicators can be classified into three categories according to their usual timing in relation to the business cycle:
 - ✚ leading indicators,
 - ✚ lagging indicators,
 - ✚ coincident indicators and
 - ✚ composite indicators.

Leading indicators

- ❖ Leading indicators are indicators that usually change **before** the economy as a whole changes.
- ❖ They show us (lead) where the **economy is going**.
- ❖ They arrive at the turning points (peak and trough) before the economy does.
- ❖ They are therefore useful as **short-term predictors** of the economy.
- ❖ Stock market returns are a leading indicator: the stock market usually begins to decline before the economy as a whole declines and usually begins to improve before the general economy begins to recover from a slump.
- ❖ Other leading indicators include the index of consumer expectations, building permits, and the money supply
- ❖ They give consumers, businesses and the state a glimpse of the direction in which the economy might be heading.

Examples:

- ❖ job advertising space
- ❖ inventory; and sales
- ❖ Average weekly hours (manufacturing)
- ❖ Average weekly jobless claims for unemployment insurance
- ❖ Manufacturers' new orders for consumer goods/materials
- ❖ Vendor performance
- ❖ Manufacturers' new orders for non-defence capital goods
- ❖ Building permits for new private housing units.
- ❖ Money Supply
- ❖ Interest rate spread
- ❖ Index of consumer expectations
- ❖ Nett new companies registered
- ❖ Number of new vehicles sold
- ❖ Nett gold and other foreign reserves
- ❖ Share prices
- ❖ Real export of goods (gold excluded)
- ❖ Gross operating surplus as % of GDP
- ❖ Commodity prices in US \$ for a basket of SA export commodities

Lagging indicators

- ❖ Lagging indicators are indicators that usually change **after** the economy as a whole changes.
- ❖ They peak after the level of the economy and the coincident indicators
- ❖ Typically the **lag is a few quarters** of a year.
- ❖ The unemployment rate is a lagging indicator: employment tends to **increase two or three quarters after** an upturn in the general economy.
- ❖ Lagging indicators won't change direction until after the business cycle has changed its direction.

Examples:

- ❖ hours worked in construction
- ❖ total of commercial vehicles sold
- ❖ The average duration of unemployment (inverted)
- ❖ The value of outstanding commercial and industrial loans
- ❖ The change in the Consumer Price Index for services
- ❖ The change in labour cost per unit of output
- ❖ The ratio of manufacturing and trade inventories to sales
- ❖ The ratio of consumer credit outstanding to personal income
- ❖ The average prime rate charged by banks

Coincident indicators

- ❖ Coincident indicators change at **approximately the same time** as the whole economy, thereby providing information about the current state of the economy.
- ❖ A coincident index may be used to identify, after the fact, the dates of peaks and troughs in the business cycle.

Examples:

- ❖ Number of employees on non-agricultural payrolls
- ❖ Personal income less transfer payments
- ❖ Industrial production
- ❖ Manufacturing and trade sale
- ❖ Real retail sales
- ❖ Real merchandise imports
- ❖ Gross value added at constant prices excluding agriculture, forestry and fishing
- ❖ Value of wholesale, retail and new vehicle sales at constant prices

Composite indicators:

- ❖ A composite indicator is a summary of various indicators of the same type into one single index.
- ❖ The three composite indicators (leading, lagging and coincident) are often used to calculate a single composite indicator to benchmark a country's economic performance.
- ❖ A composite indicator measures multi-dimensional concepts e.g. competitiveness, e-trade or environmental quality, which cannot be captured by a single indicator.
Ideally a composite indicator should be based on theoretical framework which allows individual indicators to be selected, combined and weighted in a manner which reflects the dimensions or

TOPIC:

PUBLIC SECTOR

4. Discuss in detail the main objectives of the public sector in the economy
 Economic growth - Full employment - Exchange rate stability - Price stability - Economic equity

State's macro-economic objectives

The **MNEMONIC** (acronym used to aid recall) for macro-economic objectives is **EFEPE**.

- E: **E**conomic growth
- F: **F**ull employment
- E: **E**xchange rate stability
- P: **P**rice stability
- E: **E**conomic equity

Introduction:

Governments have always had general objectives for the macro-economy. These objectives are normally referred to as the state's macro-economic objectives: here listed are South Africa's.

Economic growth

- ❖ Economic growth refers to an increase in the **production capacity** of a country.
- ❖ SA targets 4 – 5% economic growth.
- ❖ The SA government wants this because of the wealth of benefits it brings such as **increasing material living standards**.
- ❖ The government today stresses the importance of **sustainable economic growth** – economic growth that can continue over time and does not endanger future generations' ability to expand productive capacity.
- ❖ This can be achieved if increases in **aggregate supply** match increases in **aggregate demand**.
- ❖ Government tries to achieve economic growth that can match trend growth, which is the expected increase in potential output over time.
- ❖ It is essentially a measure of how fast an economy can grow without generating inflation.
- ❖ Government is now seeking economic growth that does not heavily deplete **non-renewable resources** and resources that do not damage the environment.
- ❖ Economic growth leads to **economic development**.

Full Employment

- ❖ South African government aims for full employment which is a situation where those **willing** and **able** to work can **find employment** at the going wage rate or **create employment** for themselves.
- ❖ This does not mean everyone in the population is employed.
- ❖ If government successfully encourage a high proportion of people to be **economically active**, this should raise the **productive potential** of the economy and reduce the **cost of state benefits**.

Exchange Rate Stability

- ❖ South Africa pursues stable exchange rates to attract foreign capital.
- ❖ The central bank may **increase** or **decrease** the **money supply** to maintain this rate.
- ❖ Stable exchange rates generally are viewed as favourable.

Price Stability

- ❖ A third macroeconomic policy objective is to achieve **low stable inflation**.
- ❖ This does not mean inflation at **zero per cent**, but a low and **consistent** rate of inflation.
- ❖ SARB's inflation target is between **3% and 6%**.

- ❖ South African government aims for this because it can bring benefits, such as enabling firms to reduce their costs by **not raising wages** with inflation.

Economic equity

- ❖ The **redistribution of income** through **tax** and **benefits** may be done in order to ensure that everyone has access to the basic necessities or in order to correct what is seen as inequitable distribution of income.
- ❖ The Government **transfers** some income from the rich to the poor, but not so much that it damages incentives so that work and enterprise are discouraged.
- ❖ Government will also want to avoid making living off benefits more attractive than working.

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TOPIC:

PUBLIC SECTOR

5. Discuss in detail how each of the following factors contributes to poor public sector provisioning:
 Accountability - Efficiency - Assessing needs - Pricing policy - Parastatals – Privatisation / Nationalisation

Problems of the provision of public goods and services

- ❖ The **MNEMONIC** (acronym used to aid recall) for problems of public sector objectives is **PAPAPE**.

- ✚ P: **P**rivatisation
- ✚ A: **A**ccountability
- ✚ P: **P**arastatals
- ✚ A: Problem of **A**ssessing needs
- ✚ P: **P**ricing policy
- ✚ E: **E**fficiency

Privatisation:

- ❖ Privatisation is when the government sells more than **50% of the shares** of **state owned enterprises** to the **private sector**.
- ❖ The aim of privatisation is to **reduce the relative size** of the **public sector**.
- ❖ The problem with privatisation is that once privately owned, businesses will not take **public interest** into account.
- ❖ They will **recover losses** in **poorer areas** by charging users in **more affluent** areas more, or they will simply **terminate the service**.
- ❖ Leads to **undersupply** or **no supply** of **merit goods** and **oversupply** of **demerit goods**
- ❖ Promotes black economic empowerment / opportunity for all to participate in free market – benefits BEE
- ❖ Restructure ownership of state assets together with **Department of Public Enterprises** e.g. defence and transport
- ❖ If services to rural areas are fully privatised, the services to rural areas may be terminated or become more expensive

Accountability:

- ❖ Public servants do not always serve the interest of the public as they are often driven by **self-interest**
- ❖ Public servants are required to give an explanation of their decisions, actions and expenditures over a period of time
- ❖ There are mechanisms for evaluating government's economic and financial performance:
 - ✚ That the desired quantities and quality of goods and services for which taxes are raised are delivered
 - ✚ That monopolies, corruption, nepotism, incompetence and apathy does not occur
- ❖ Two important elements of accountability is **participation** and **transparency**
- ❖ **Ministerial responsibilities**, i.e. the ministers of government departments are responsible for decisions and actions and expenditures
- ❖ **Parliamentary questioning** arises and members of the government departments have to respond
- ❖ The National Treasury is responsible for **treasury control**
- ❖ The **Auditor-General** reports annually in writing on each government department

Parastatals

- ❖ **State-owned enterprises** (SOEs) are legal entities that undertake commercial activities on behalf of an owner government.
- ❖ They focus on making a profit and maximizing cost at the expense of the needs of some groups (e.g.) Iscor SABC, SAA, Spoornet

The problem of Assessing needs

- ❖ State owned enterprises do not operate according to the forces of **supply** and **demand**
- ❖ It becomes thus very difficult for state-owned enterprises to **assess needs** and they are thus prone to **under-** or **over-supplying** public goods and services
- ❖ The census and other household surveys as well as local government structures provide this type of information
- ❖ Since resources are **scarce**, government must then decide which needs and whose needs are to be satisfied
- ❖ In the private sector houses are built according to the price that people are able and willing to pay
- ❖ In the public sector housing is regarded as a social responsibility and authorities supply them according to the needs of people

Pricing policy

- ❖ In a market economy prices are determined by **supply** and **demand**
- ❖ It is difficult for the state to come up with the **appropriate pricing strategy** for goods/services, sometimes the **cost exceeds** the revenue e.g. TV licence fees in SABC
- ❖ The objectives of firms are to maximise their profits and they usually set prices to achieve this objective
- ❖ Government is not set confined to the **profit maximisation** objective
- ❖ Government takes into account certain social, economic, political and environmental conditions as well as **public opinion** and these include:
 - ✚ **Free-of-charge services:**
 - This is met from taxes and applies to most community goods (e.g.) defence, police and collective goods whereby charges and toll fees are levied
 - Welfare is maximised if the cost of providing some goods are met with taxation
 - ✚ **Community goods:**
 - No price can be charged for these services
 - ✚ **Collective goods:**
 - Charges can be levied
 - Free-riders are excluded by levying taxes
 - Examples, visiting museums, parks, etc.
 - ✚ **User-charges:**
 - Option to charge depends on technical reasons (e.g.) cost of providing a double lane road could be recovered by toll charges.
 - Economic reasons such as services like water and electricity that have a zero price political reasons where income distribution is significantly unequal, administrative rationing according to need takes place (e.g.) public health and education
 - ✚ **Direct and indirect subsidies:**
 - Direct subsidies are used to cover part of the costs (e.g.) urban bus service and an indirect subsidy is used to write off accumulated losses or deficits.
 - Standing charges called availability charges (e.g.) water and electricity standing charges goes to meet fixed costs and the price per unit consumed covers variable costs
 - ✚ **Price discrimination:**
 - Different users have different elastic ties of demand for a good (e.g.) commercial and manufacturing businesses pay higher rates than households and they pay on a sliding scale.

Efficiency

- ❖ Public goods are efficiently provided if **Pareto efficiency** (a state of allocation of resources in which it is impossible to make any one individual **better off** without making at least one individual **worse off**) is achieved
- ❖ There are three major reasons for inefficiency:
- ❖ **Bureaucracy**: the official rules and procedures (red tape)/insensitivity to the needs of their clients
- ❖ **Incompetence**: the lack of skill or ability to do a task successfully/ may have improper qualifications/or an attitude of apathy
- ❖ **Corruption**: the exploitation of a person's position for private gain / taking bribes, committing fraud, nepotism

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International Trade Possible Essays

[**NO ESSAYS** were identified for the next three-year cycle.]

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TOPIC:

Protectionism and Free Trade

6. Discuss in detail export promotion and import substitution:

Definition - Methods – Reasons / Advantages – Disadvantages

Introduction:

Export promotion is an umbrella term for economic policies, development interventions and private initiatives to **improve the trade performance** of an **economic area** (like countries or regions within countries) or enterprises. Improvement is mainly sought by increasing exports both in **absolute terms** as well as **relative to imports**, but trade promotion also, for example, enhancing a company's sourcing of inputs through imports.

Reasons for promoting export

- ❖ The country achieves significant **export-led economic growth**.
- ❖ Export promotion **enlarges the production capacity** of the country.
- ❖ Export markets are **much bigger** than local markets.
- ❖ More workers will be **employed**.
- ❖ Prices will be reduced

Approaches/Methods**Incentives:**

- ❖ The government supplies information on export markets, research on new markets, concessions on transport charges, export credit, etc. in order to stimulate exports.
- ✚ These incentives encourage manufacturers to export an increasing amount of their production

Subsidies:

- ❖ These include direct and indirect subsidies:
 - ✚ **Direct subsidies:** Cash payments to exporters.
 - ✚ **Indirect subsidies:** Refunds on import tariffs and general tax rebates.
 - ✚ The challenge for governments is to design incentives and subsidies in such a manner that the prices of export goods cannot be viewed as **dumping**.
 - ✚ If not, the countries receiving the imports are allowed to retaliate with tariffs.
 - ✚ **Dumping** means selling goods in a foreign market at prices that are below their cost of production.

Trade neutrality:

- ❖ Subsidies **equal in size to import duties** are paid.
- ❖ Since the protection of domestic industries raises the cost of inputs for potential export producers, the latter can only become internationally competitive and experience growth in exports if the cost-raising effects of protection are **neutralised** by **direct** and **indirect subsidies**.
 - ✚ **Neutrality** can be achieved through **trade liberalisation**.
 - ✚ A popular alternative method of obtaining neutrality in a developing country that has implemented protection measures is the establishment of **export processing zones (EPZs)**
 - ✚ An **EPZ** is a **free trade enclave** within a protected economy.
 - ✚ It is fenced and controlled industrial park that falls outside the domestic customs area and is usually located near a harbour or airport

Advantages of export promotion

- ❖ There are **no limitations to size of scale** since the market is very large.
- ❖ Production is based on cost and efficiency.
- ❖ There is **increased domestic production**.
- ❖ Exchange rates would be realistic and there is **no need for exchange control** and **quantitative restrictions**.
- ❖ **Value can be added** to natural resources of the country.
- ❖ Creates **employment opportunities**.
- ❖ An increase to exports has a positive effect on the balance of payments.
- ❖ Increase in production leads to **lower domestic prices**, which benefit local consumers.

Disadvantages of export promotion

- ❖ The **real cost** of production is reduced by subsidies and incentives.
- ❖ The **lack of competition** because of incentives and subsidies forces competitors out of the market.
- ❖ Export promotion results in **increased tariffs** and **quotas** by powerful overseas competitors.
- ❖ Export promotion results in the protection of **labour-intensive industries** by developed countries.
- ❖ Withdrawal of incentives often leads to **closure of affected companies**, which leads to an increase in unemployment.
- ❖ Incentives often lead to **inefficiencies in the production process**, since companies don't have to do their best to compete, it can be seen as dumping

Introduction:

Government strategy that emphasises **replacement** of some agricultural or industrial imports to encourage local production for local consumption, rather than producing for **export markets**. **Import substitutes** are meant to generate employment, reduce foreign exchange demand, stimulate innovation, & make the country self-reliant in critical areas such as food, defence, & advanced technology.

Reasons for import substitution

- ❖ **Diversification:** Expansion of manufacturing makes economies less dependent on foreign countries
- ❖ **Trade:** Developing countries rely on their natural resources as a basis for economic growth and development.
- ❖ Exports consist of primary goods such as minerals and agricultural produce
- ❖ Increase employment opportunities
- ❖ To establish domestic industries
- ❖ To replace imports by encouraging local economic growth
- ❖ To correct BOP problems
- ❖ To create national independence

Approaches/Methods

Tariffs:

- ❖ A tariff is a tax or duty to be paid on a particular class of imports or exports.
- ❖ They can be ad valorem, composite / multiple or specific.
- ❖ **Ad valorem:** a percentage of the value on luxury goods, such as motorcars, jewellery and perfumes.
- ❖ **Specific:** an amount per unit, mass or size, e.g. food, animals and plants.
- ❖ **Composite / multiple:** when a specific tariff and an ad valorem tariff are levied on imported products e.g. R10 is levied on a product plus a percentage of 20% of the value of the product

Quotas:

- ❖ Quotas are restriction on the quantity of goods that can be imported.

Subsidies:

- ❖ to domestic enterprises that export goods may be used as an indirect way of protecting them

Exchange control:

- ❖ A government or free trade area may seek to reduce imports by limiting the amount of foreign exchange made available to those wishing to import goods and services

Physical control:

- ❖ takes the form of a complete ban or embargo on the import of certain goods

Diverting trade:

- ❖ Import deposits, Time-consuming customs procedures, Quality standards.

Voluntary import substitution:

- ❖ Where a country decides of its own free will to replace goods that are imported

Forced import substitution:

- ❖ When a country is forced to produce certain goods because they are excluded from taking part in international trade / boycotts, sanctions, disinvestment

Advantages of import substitution

- ❖ Increased employment **stimulates the economy** and **GDP increases**
- ❖ **Bigger variety of products** produced/Diversification/Broader industrial base
- ❖ Decrease in imports will have a **positive effect on BOP**
- ❖ **Industrial development encouraged** which contributes revenue to the treasury
- ❖ **Easy to implement** through the imposition of tariffs and quotas /Method of restricting imports
- ❖ **More choice** because goods are locally produced. The foreign exchange that becomes available can be used for other imports, thereby increasing the choices made available to consumers

Disadvantages of import substitution

- ❖ Capital and **entrepreneurial talent are drawn away** from the areas of comparative advantage
- ❖ Technology is often **borrowed from abroad** where capital is relatively abundant
- ❖ It **lowers the competitiveness of sectors** where a comparative advantage exists
- ❖ It often leads to demands for protection to industries that provide inputs
- ❖ Policy often causes exchange rates to be overvalued – discourage exports
- ❖ Does not necessarily lead to an overall reduction in imports – SA imports capital and intermediate goods
- ❖ Local production can be **inefficient**
- ❖ Domestic consumers are forced to buy goods at prices that are higher than prices of goods on international market
- ❖ Costly and uneconomical projects

TOPIC:

DYNAMICS OF PERFECT MARKETS

7. Compare and contrast the FOUR broad types of market structures (perfect competition, monopolistic competition, oligopoly and monopoly) in detail in terms of the following.

Number of businesses - Nature of product - Entrance - Control over prices - Information - Examples - Demand curve - Economic profit/loss - Decision-making - Collusion - Productive/Technical efficiency - Allocative efficiency

Criterion	Perfect competition	Imperfect competition		
		Monopolistic Competition	Oligopoly	Monopoly
Number of firms	So many that no individual firm can influence the market price	So many that each firm thinks other will not detect its actions	So few that each firm must consider the others' actions and reactions	One seller
Nature of product	Homogeneous/standardised	Heterogeneous/differentiated	Homogeneous or heterogeneous	Unique
Entry	Completely free	Free	Varies from free to restricted	Completely blocked
Collusion	Impossible	Impossible	Possible	Impossible
Information	Complete	Incomplete	Incomplete	Complete
Firm's control over price	None, they are price takers	Little control but they are mostly price makers	Considerable, but less than in case of a monopoly. Price makers / price setters	Considerable, but limited by market demand and the goal of profit maximisation. Price makers / price setters
Demand curve for the firm's product	Horizontal (perfectly elastic)	Downward sloping (relatively elastic)	Downward sloping; may be kinked	Equals market demand curve: downward sloping (relatively inelastic)
Long-run economic profit	Normal profit	Normal profit	Economic profit	Economic profit
Decision making	Decision making has no influence of other firms	Decision making is influenced by other firms	Decision making is influenced by other firms	Decision making is independent
Allocative efficiency	Yes, it is possible to achieve allocative efficiency	Monopolistic firms are close to being allocatively efficient.	No, an oligopoly cannot achieve allocative efficiency.	No, a monopolist can never achieve allocative efficiency.
Productive efficiency	Yes, it is possible to achieve productive efficiency	Monopolistic firms are close to being productively efficient.	No, oligopolies will not achieve productive efficiency.	No, monopolies will not achieve productive efficiency.
Examples	Farmers for maize/ tomatoes/ rice etc., international commodity markets e.g. gold, oil, JSE etc.	Fast food outlets, restaurants cereal, clothing, shoes, etc.	Banking, cellphone network providers, cigarette, mealie meal, petrol, cement, washing powder etc.	Eskom, Transnet

TOPIC:

DYNAMICS OF PERFECT MARKETS

8. Examine in detail the various equilibrium positions with the aid of graphs.

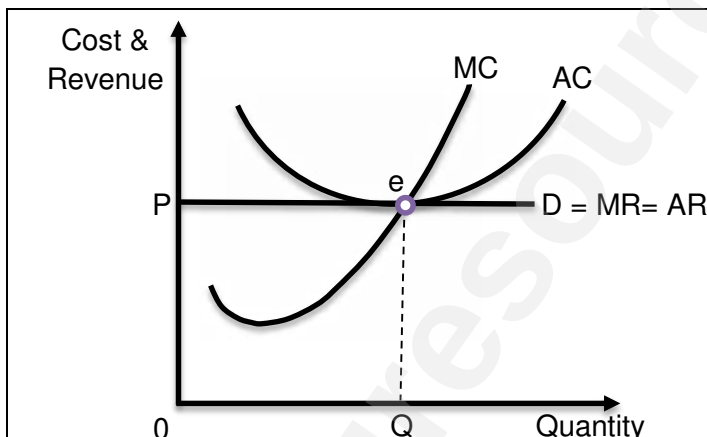
Explain economic profit, economic loss, normal profit with the aid of graphs (short run) - Explain normal profit with the aid of a graph (long run) - Explain shutdown point using costs and revenue (FC, VC, TC, TR) and explain graphically (AR and AVC)

Introduction

A profit is a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity. $P = TR - TC$

Normal profit [Short-run]

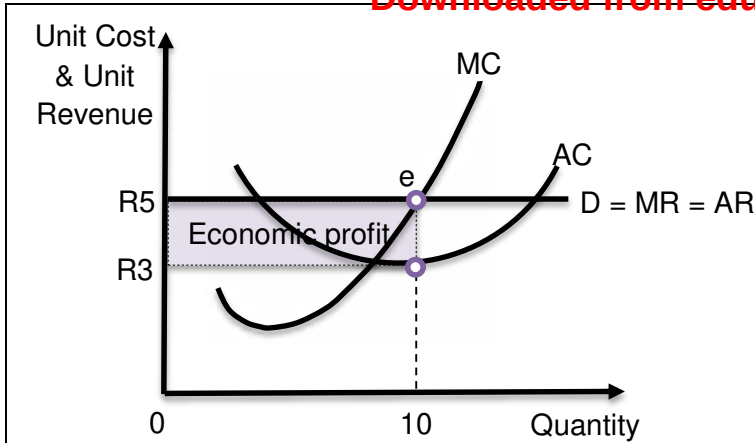
- ❖ When economic profit is equal to **zero**; this occurs when the difference between total revenue and total cost (explicit and implicit costs) equals zero.
- ❖ **Normal profit** is different from **accounting profit** because **opportunity cost** is taken into consideration. It is the **minimum level of profit** needed for a company to remain competitive in the market.
- ❖ Normal profit occurs at the point at which the resources available to the firm are being **efficiently used** and could not be put to better use elsewhere.
- ❖ It is important to note that zero economic profit does not mean that the company is not earning any money (accounting profit).
- ❖ It is simply a measure of how well resources are being used relative to all possible options.



- ❖ In the graph on your left we see that average cost (AC) is equal to the average revenue (AR). This means that total revenue (TR) is equal to total cost (TC).
- ❖ Normal profit is the minimum amount needed to keep entrepreneurs in business.
- ❖ The point where AC intersects AR (point e) is referred to as the break-even point.
- ❖ The business is still maximising profit because $MC = MR$.
- ❖ Normal profit $\rightarrow TR = TC$ or $AR = AC$

Economic profit [Short-run]

- ❖ Don't confuse this with 'accounting profit', which is what most people generally mean when they refer to profit.
- ❖ In calculating economic profit, opportunity costs are deducted from revenues earned.
- ❖ Opportunity costs are the alternative returns foregone by using the chosen inputs.
- ❖ As a result, you can have a significant accounting profit with little to no economic profit.



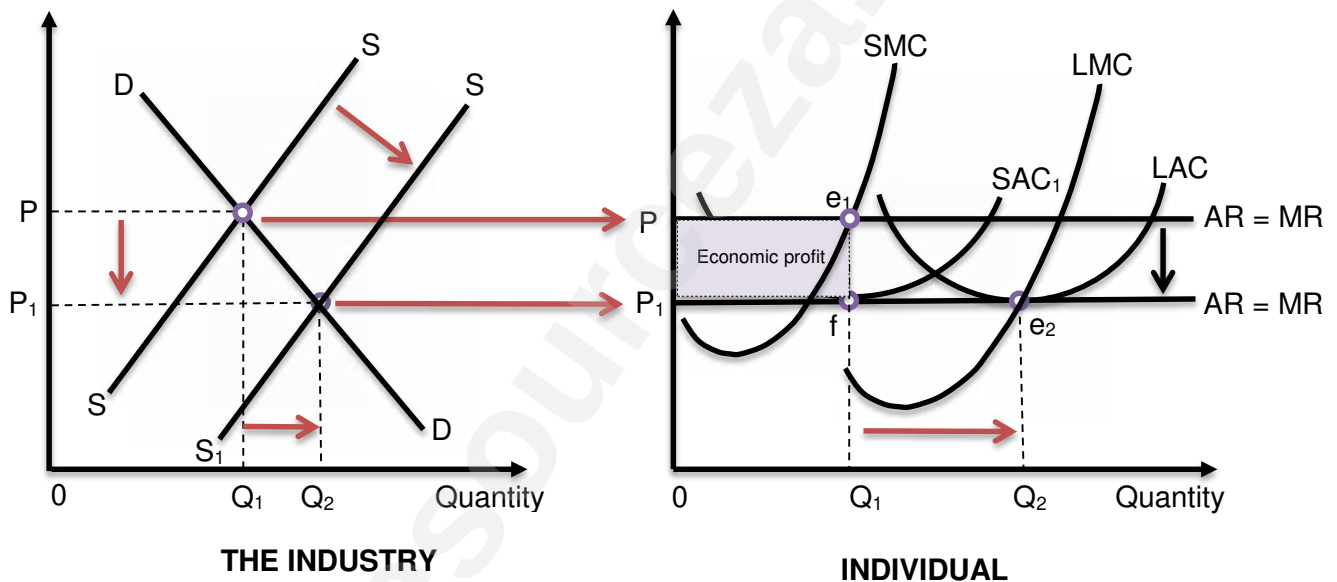
- ❖ The graph on your left shows an individual firm making economic profit in the short-run.
- ❖ It is short-run because firms cannot make economic profit in the long-run.
- ❖ The firm is making economic profit because average revenue is greater than average cost ($AR > AC$).
- ❖ To calculate the economic profit made by the firm, we use the formula $TR - TC$ / $AR - AC \times Q$ which is:

$$R50 (R5 \times 10) - R30 (R3 \times 10) = R20$$

$$R5 - R3 = R2 \times 10 = R20$$

Normal profit [long-run]

- ❖ In the long run, perfectly competitive markets are **both allocatively and productively efficient**



In the long run, two things can change:

1. **New firms can enter** the industry and existing firms can leave.
2. All factors of production **became variable** and existing firms earning economic profit in the short run may decide to **expand** their plant size to realize **economies of scale** (cost advantages that enterprises obtain due to size, output, or scale of operation, with cost per unit of output generally decreasing with increasing scale as fixed costs are spread out over more units of output).

Smaller plant, higher unit cost

- ❖ Suppose the business's short-term plant is represented by SAC_1 .
- ❖ If the market price is P the business is making an **economic profit** of $P - e_1 - f - P_1$ (shaded area) with the short-term plant-size represented by SAC_1 .
- ❖ At a price of P the business will maximise profit in the short-term at point e_1 where the profit maximisation ($MR=MC$) applies, and the quantity Q_1 will be produced.

Bigger plant, lower unit cost

- ❖ If the producer does a cost estimate, he/she will realize that, if he/she will be able to produce at a lower unit cost in the long-run,
- ❖ As illustrated by the downward sloping portion of the LAC curve.

- ❖ The prospect of increased profit would therefore encourage the producer to build a bigger plant.
- ❖ The business would however not be interested in producing output levels greater than those presented by the minimum point e_2 of the LAC because such output levels are only possible at higher cost levels – internal scale disadvantages cause the LAC to rise to the right of point e_2 .

New entrants, increased supply

- ❖ The economic profit that businesses make is likely to attract new businesses to the industry.
- ❖ Because the quantity offered on the market increases as a result of expansion by existing businesses and the entry of new businesses.
- ❖ The supply curve on the market will shift to the right from S to S_1 and the price will drop until it eventually reaches P .
- ❖ At the price P , which is at the same level as the minimum point of the LAC curve, total revenue ($P \times Q_2$) is equal to total cost ($P \times Q_2$)
- ❖ And the business is making normal profit, because it is exactly covering its total cost.
- ❖ Over time all the businesses in the industry will make normal profit and will be in long-term equilibrium.

Initial losses

- ❖ Individual firms can be in equilibrium in the short run where it makes an economic profit or an economic loss.
- ❖ These positions, however, are not sustainable in the long run under conditions of perfect competition.
- ❖ If the market price is below the minimum point of the long-term average cost curve, the adjustment process simply works the other way around.
- ❖ Eventually the LAC curve will also form a tangent with the demand curve and the businesses that have remained in the industry will be making normal profit.

Price in the long term

- ❖ The above analyses leads to the conclusion that under perfect competition the price of a product in the long term will settle at a level that corresponds to the lowest point of the LAC curve.
- ❖ A point such as e_2 represents the equilibrium point of the business in the long run.
- ❖ The business is making normal profit and there will be no incentive to leave or enter the industry.
- ❖ When a market price has been established under perfect competition at a level where each business is in equilibrium at the minimum point of its LAC curve and only making normal profit, the industry will also be in long-term equilibrium.

Equilibrium

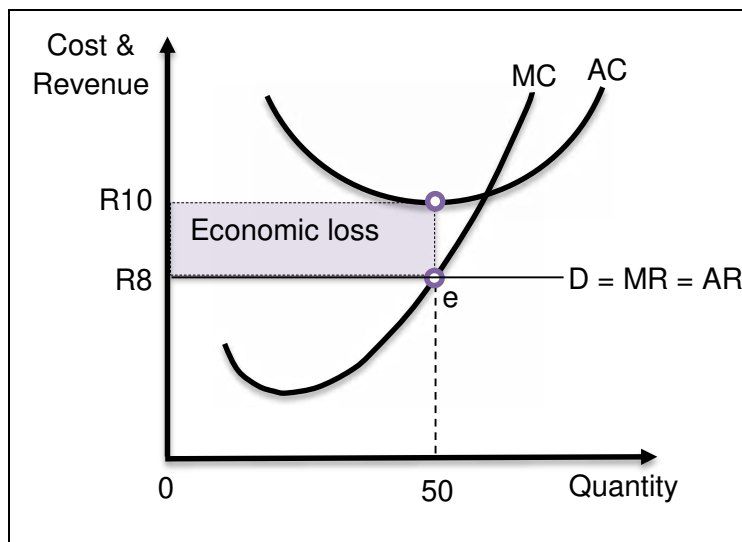
- ❖ Once long-term equilibrium has been achieved, and provided that there are no changes in the technology or the factors of production, there will be no further entry or exit of businesses
- ❖ The output is produced at the lowest possible cost (minimum point of LAC).
- ❖ The consumer pay the lowest possible price for the product (price = the lowest cost at which the product can be produced).
- ❖ The price of the product = the opportunity cost of producing the product. All businesses are making normal profits only

Losses and supply

A loss is a negative difference between market price (P) and cost of production (TC). When the price is equal to or higher than AC per unit, then the firm makes a **profit**. **BUT** if the price is below AC per unit and TR is less than TC , then the firm makes an **economic loss**.

Economic loss [Short-run]

- ❖ In the **short run**, an individual producer makes an economic loss when average revenue is less than average cost ($AR < AC$).
- ❖ However, this equilibrium position changes to normal profit in the long-run as firms exit the industry.
- ❖ This will reduce market supply, causing the market price to increase until it is equal to average cost.

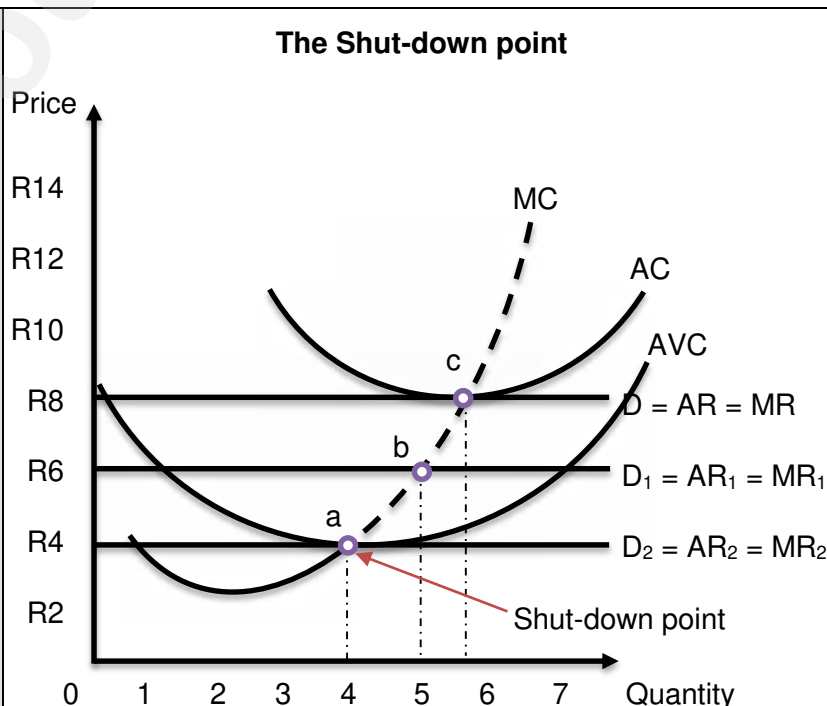


- ❖ The graph on your left represents an individual firm making economic loss in the short-run.
 - ❖ It is short run because economic loss is impossible in the long-run because no firm can survive economic loss in the long-run.
 - ❖ The firm is making an economic loss because average revenue is less than average cost ($AR < AC$ / $R8 < R10$)
 - ❖ To calculate the economic loss, we use the formula $TR - TC$ / $AR - AC \times Q$, which is:
 - + $R400 (R8 \times 50) - R500 (R10 \times 50) = -R100$
- OR**
- + $R8 - R10 = -R2 \times 50 = -R100$

The Shut-down Rule

- ❖ In the short run, a firm that is operating at a loss (where the revenue is less than the total cost or the price is less than the unit cost) must decide to operate or temporarily shut-down.
- ❖ The **shutdown rule** states that "in the short run, a firm should continue to operate if price exceeds average variable costs ($P > AVC$)."
- ❖ When determining whether to shut-down a firm has to compare the total revenue (**TR**) to the total variable costs (**TVC**).
- ❖ If the total revenue the firm is making is greater than the total variable cost ($TR > TVC$) then the firm is covering its variable costs and there is additional revenue to partially or entirely cover the fixed costs.
- ❖ On the other hand, if the total revenue is equal or less than the total variable cost ($TR \leq TVC$) then the firm is not even covering production costs and it should be **shut-down** immediately.

- ❖ The dotted part of the marginal cost curve represents the supply curve of the business.
- ❖ The supply curve starts at point a (shutdown-point) and slopes upward from there due to the marginal cost (MC) that increases as output increases.
- ❖ At a market price of R8 the business can continue producing because it will be making a normal profit ($AR = AC$).
- ❖ If the market price drops below R6 the business can still survive because $AR > AVC$.
- ❖ If the price drops to R4, the firm will be forced to close down because $AR = AVC$.
- ❖ Therefore, any price above R4, the firm can survive because it can cover its AVC. Any price below R4, the firm should shut-down because it cannot cover its AVC.



TOPIC:

DYNAMICS OF IMPERFECT MARKETS

9. Discuss the monopoly in detail

Introduction

- ❖ In its pure form, monopoly is a market structure in which there is **only one seller** of a good or service that has **no close substitutes**. It is the **opposite extreme** to **perfect competition** in the spectrum of market structures.

Characteristics

Number of firms

- ❖ A perfectly competitive industry consists of a large number of small firms, conversely, a monopoly consists of **one single firm**
- ❖ The monopolist represents the **entire industry**.

Nature of product:

- ❖ The product is **unique** and it has no close substitute

Entry:

- ❖ Monopolies are usually the result of **barriers to entry** which protect monopolists from potential competition
- ❖ Such barriers include patents, licences, sole rights, import restrictions, the limited size of the market and exclusive ownership of raw materials.
- ❖ However, in the modern era of globalisation, local monopolists are increasingly subject to international competition which limits their monopoly power.

Collusion:

- ❖ It is **impossible** for one firm to collude because collusion involves two firms or more

Information:

- ❖ This refers to market participant's information on market conditions.
- ❖ For a monopolist all information on market conditions is **available** to both buyers and sellers.
- ❖ This means that there are no uncertainties.
- ❖ This assumption also applies in the case of the monopoly.

Control over price:

- ❖ The monopolist is a **price maker** even though that control is limited by market demand and the goal of profit maximisation.

Demand curve:

- ❖ The demand curve is **downward sloping**. Because the monopolist is the only supplier of the product in the market, the demand curve that confronts the monopolist is that of the market as a whole that is, the market demand curve which slope downwards from left to right.
- ❖ Monopolists are the only supplier of the product, so they decide at what point on the demand curve they wish to be.

Long-run economic profit:

- ❖ It is possible for a monopolist to make an **economic profit** in the long-run because new entries are **blocked** and short-run economic profit therefore cannot be reduced by new competing firms entering the industry
- ❖ The monopoly can thus continue to earn **economic profit** as long as the demand for its product remains intact

Output:

- ❖ It is **low** with no choice or variety available to consumers

Non-price competition:

- ❖ **None**, due to the fact that there is no competition

Decision-making:

- ❖ Decision making is independent because a monopolist is the only firm in the entire industry.

Productive/Technical efficiency:

- ❖ Monopolies will not achieve productive efficiency as firms will produce at an output which is less than the output of minimum ATC.

Allocative efficiency:

- ❖ A monopolist can never achieve allocative efficiency.
- ❖ It will always produce too few of its good or service and will always charge too much for it or them.
- ❖ In a monopoly, entry is blocked and so the monopoly remains free to charge the higher price and produce a lower quantity.

Examples:

- ❖ Eskom and Transnet

TOPIC:

DYNAMICS OF IMPERFECT MARKETS

10. Examine the oligopoly in detail**Introduction**

An oligopoly is a market in which a small number of relatively large known as oligopolists businesses supply most of or all the market, e.g. oil industry, telecommunication industry, etc.

Characteristics of an oligopoly

- ❖ **Number of firms:** So **few** that each firm must consider the others' actions and reactions
- ❖ **Nature of product:** In a differentiated oligopoly the products are **heterogeneous** (e.g. service offered by banks is heterogeneous) and in a pure oligopoly the products are **homogeneous** (e.g. petrol is homogeneous)
- ❖ **Entry and exit:** Entry is **free** but there are **significant barriers of entry** usually due to large amounts of capital required, existing competition, access to raw materials and licencing
- ❖ **Collusion:** Collusion is **possible** and a common feature of an oligopolistic market, since this market structure comprises of a few firms, but collusive practices are **illegal** in South Africa, according to the Competition Act 1998. This is because if they collude, they become a cartel, which is more like a monopoly. The absence of competition will mean that consumers will have to pay more and output will even as low as in case of a monopolist.
- ❖ **Information:** It is **incomplete**
- ❖ **Control over price:** An oligopolist is a **price maker**, but the firm's control over price is less than in case of a monopoly. Price changes occur more frequently
- ❖ **Demand curve:** It is **kinked**
- ❖ **Long-run economic profit:** It is possible to make an **economic profit** in the long-run
- ❖ **Output:** Output is **low** with little choice
- ❖ **Non-price competition: Yes:** competition tends not to be in terms of the price of products but through advertising, after-sales service, building brand loyalty, extended shopping and business hours, loyalty rewards for customers, door-to-door deliveries and product differentiation
- ❖ **Examples:** Banking, cellphone network providers, cigarette, vehicle industries

TOPIC:

MARKET FAILURE

11. Discuss in detail how the following factors leading to the misallocation of resources in the market:
 Externalities - Missing markets - Imperfect competition - Lack of information - Immobility of factors of production - Imperfect distribution of income and wealth

Reasons for market failure

- ❖ The **MNEMONIC** (acronym used to aid recall) for reasons for market failure is: **MIELII**

- ✚ **M:** Missing markets
- ✚ **I:** Imperfect markets
- ✚ **E:** Externalities
- ✚ **L:** Lack of information
- ✚ **I:** Immobility of factors of production
- ✚ **I:** Imperfect distribution of income and wealth

Missing markets

- ❖ A significant market failure is the failure to produce some goods and services, despite being needed or wanted.
- ❖ Markets can only form under certain conditions, and when these conditions are absent markets may struggle to exist.
- ❖ The most extreme case of a missing market is the case of pure public goods.
- ❖ Pure public goods clearly provide a benefit to the consumer, but, for several reasons, are unlikely to exist in a market economy.
- ❖ Examples of pure public goods include national defence, the police service, and street lighting.
- ❖ Due to the fact that markets for these goods are not likely to form they are called missing markets and are considered a special case where demand exists, but supply is absent.
- ❖ **Pure public goods**
 - ✚ The market mechanism is likely to fail to supply pure public goods because entrepreneurs are unlikely to enter the market, given the impossibility of charging consumers at the point of consumption.
 - ✚ Public goods have the following characteristics:
 - **Non-excludable**
 - When a public good is supplied, it is impossible to exclude other individuals from deriving a benefit.
 - For example, once street lighting is made available in an area, all passers-by can benefit, and no one can be denied access to it.
 - **Non-rivalry**
 - When a pure public good, such as street lighting, is consumed by one individual, the stock available for others does not diminish, as it would in the case of a private good.
 - A pedestrian passing under a street light has no effect on the supply of lighting whatsoever.
 - Non-rivalry is also known as the principle of non-rivalry.
 - Because the stock of a public good does not diminish with use, consumers do not need to compete with each other to get access to them.
 - For example, individuals do not need to queue to get access to street lighting.
 - **Non-rejectable**
 - Unlike a private good, consumers cannot reject a pure public good, and are forced to consume it.

- An individual cannot reject being defended by the armed forces of a country, nor can they reject the benefit of street lighting.
- ❖ When combined, these three characteristics deter potential suppliers because it would be impossible to charge users at the point of use.

Imperfect competition:

- ❖ Markets fail because imperfect markets fail to achieve both technical and allocative efficiency, e.g. a monopolist is considered to be inefficient because it produces less and charges a higher price hence this leads to allocative inefficiency and lack of competition in this market structure tends to cause technical inefficiency.
- ❖ In market economies, competition is often impaired by power.
- ❖ Power often lies to a greater extent with producers than consumers.
- ❖ They can also prevent new businesses from entering the industry, e.g. Businesses had technology to produce long-life light bulbs for some time before they went on the market, e.g. Technology that allows cars to be driven by fuels other than fossil fuels, e.g. Debatable whether a cure for common cold would find its way onto the market easily
- ❖ Imperfect markets fail to achieve technical and allocative efficiency
- ❖ The modern market does not always allow for price negotiation
- ❖ Advertising is often employed to promote producer sovereignty

Externalities/ Spill-over effects/ Neighbourhood effects/ Third party effects

Externalities occurs when producing or consuming a good that causes an impact on third parties not directly related to the transaction. Externalities can also be defined as the costs and benefits that convert **private costs** and **private benefits** into **social cost** and **social benefits**. Externalities can either be positive or negative. They can also occur from production or consumption.

- ❖ **Positive externality in production.**
 - ✚ A farmer grows orange trees. An external benefit is that he produces nectar for a nearby bee keeper who gains increased honey as a result of the farmer's orchard
- ❖ **Negative externality in production**
 - ✚ Making furniture by cutting down trees in the rainforests leads to negative externalities to other people. It leads to higher global warming as there are less trees to absorb carbon dioxide
- ❖ **Positive externality in consumption**
 - ✚ If you take a three year diploma in education. You gain skills but also other people in the economy can benefit from your knowledge.
- ❖ **Negative externality in consumption**
 - ✚ If you smoke in a crowded room, other people have to breathe in your smoke. This is unpleasant for them and can leave them exposed to health problems associated with smoking

To understand this a bit more, one has to understand the four concepts associated with externalities:

- ❖ **Private costs**
 - ✚ These are internal costs incurred when buying or producing goods
 - ✚ Examples of private costs are costs incurred to produce a computer
- ❖ **Private benefits**
 - ✚ Private benefits are internal benefits and are benefits that accrue to those who buy or produce the goods
 - ✚ e.g. producer receives a profit from selling a laptop and the consumer gets to use it
- ❖ **Negative externalities/ Social costs**
 - ✚ These are considered to be the **private cost** plus **external cost**. Rational choice theory often assumes that individuals consider only the costs they themselves bear when making decisions, not the costs that may be borne by others.
 - ✚ The social costs of smoking include the passive smoking that other people experience
 - ✚ E.g. the social cost involved in building and running an airport can be split up into:

- Private costs of the airport: cost of construction, cost of paying workers to run airport, etc.
- External cost of the airport: noise and air pollution to those living nearby, risk of accident to those living nearby, loss of landscape.

❖ **Positive externalities/ Social benefits**

- ✚ Social benefit is the total benefit to society from producing or consuming a good/service
- ✚ Social benefit include all the **private benefits** plus any **external benefits** of production/consumption
- ✚ If a good has significant external benefits, then the social benefit will be greater than the private benefit.
- ✚ E.g. cycling to work. If we cycle to work, the private benefits include health benefits for cycling, avoiding congestion, lower cost of cycling rather than driving. Social benefit of cycling may also include lower congestion for other road users, lower pollution levels.

Lack of information

- ❖ Technical and allocative efficiency require that both producers and consumers have complete and accurate information about the costs and benefits of the goods and services produced and consumed in the market. Producers and consumers make production and consumption decisions based on the information they have.
- ❖ When information is incomplete or inaccurate, it leads to wrong decisions about what to produce, how to produce and for whom to produce, and a waste of resources occurs.
- ❖ Producers might not know all the different technologies and production techniques that are available and the different resources that can best be used to produce goods/services more efficiently
- ❖ Consumers might not know that the price of a product is lower from some other suppliers or about the harmful effects of a product since they might just base their decisions to consume on the information from a misleading suppliers

Imperfect distribution of income and wealth

- ❖ There is an unequal distribution of income and wealth because the market is only interested in distributing goods/services for those who can afford it
- ❖ Other reasons for unequal distribution of income and wealth:
 - ✚ Discrimination
 - ✚ A difference in market power
 - ✚ Unequal access to markets and educational opportunities

Immobility of factors of production

Resources may not be very mobile at the best of times and therefore markets are not able to adjust as rapidly to changes in demand and supply

❖ **Labour**

- ✚ **Geographic immobility of labour:** people are usually happy where they are, they have relatives and friends, they know the town and area, and they are members of various clubs and other social groupings.
- ✚ **Institutional immobility of labour:** pension schemes may tie people into a particular company – if a worker moves, he or she will probably lose the amount paid in by the employer on their behalf. Foreign-trained doctors may not be allowed to work in another country unless they spend several years retraining.
- ✚ Married or very close couples may not be able to take a better paid job offered elsewhere because it would render the other partner unemployed, so total family income would fall if they moved

❖ **Physical capital**

- ✚ Some capital is specific, e.g., it makes mugs, and cannot be transferred to another use, like producing ball point pens
- ✚ Some capital is very big and heavy, e.g., a steel mill, and is difficult or impossible to move it to another geographic area

TOPIC:

MARKET FAILURE

12. Discuss in detail state intervention as a consequence of market failures, with the aid of relevant graphs

Direct control - Imperfect markets - Minimum wages - Maximum prices - Minimum prices - Taxes and subsidies - Subsidies on goods and services - Redistribution of wealth - Government involvement in production

State intervention as a consequence of market failures

Direct control:

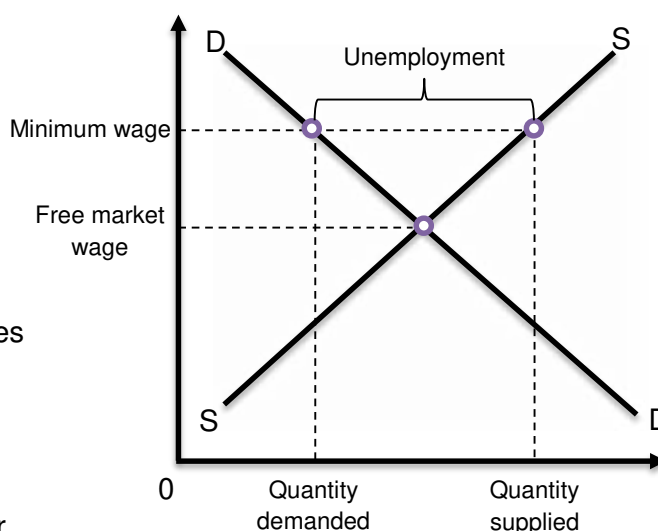
- ❖ The government can pass laws or use existing legislative framework to control businesses that generate negative externalities.
- ❖ **Positive externalities**
 - + Government can grant a subsidy to encourage consumption of goods with a positive externality.
 - + In a free market, there is under consumption of goods with positive externalities because people usually ignore the external benefits their decisions make
- ❖ **Negative externalities**
 - + To achieve a more socially efficient outcome, the government could try and tax the goods with negative externalities. This means that consumers pay the full social cost.
 - + This reduces consumption and creates a more socially efficient outcome.

Imperfect markets:

- ❖ Government can deal with imperfect competition by:
 - + Formulating and implementing a competition policy to increase the level of competition
 - + Imposing price controls and using legislation to decrease the price of a product
 - + Granting of licences to other firms in case of state monopoly

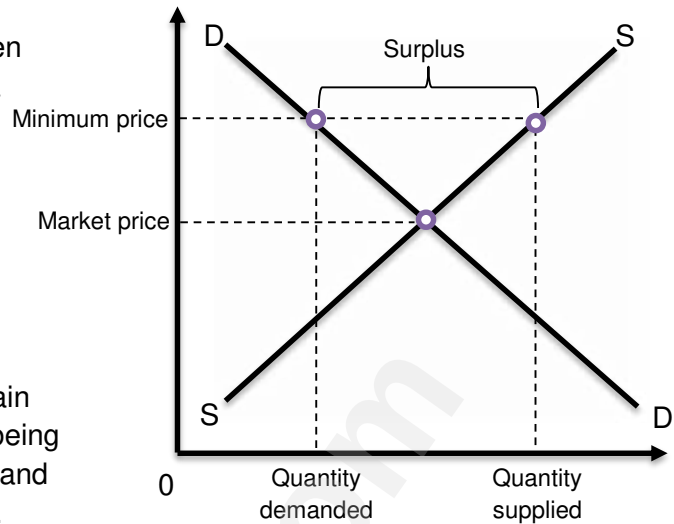
Minimum wages:

- ❖ A minimum wage is the lowest remuneration that employers may legally pay to workers.
- ❖ Equivalently, it is the price floor below which workers may not sell their labour.
- ❖ A minimum wage decreases demand for labour and increases supply of labour.
- ❖ The graph on your right shows the effect of setting minimum prices by government. If wages are set at a price higher than market wage, demand will be exceeded by supply, thereby creating a situation where many people are willing to supply their labour but businesses are not willing to hire due to the fact that labour will be expensive. This leads to high unemployment rates due to the excess supply of labour.



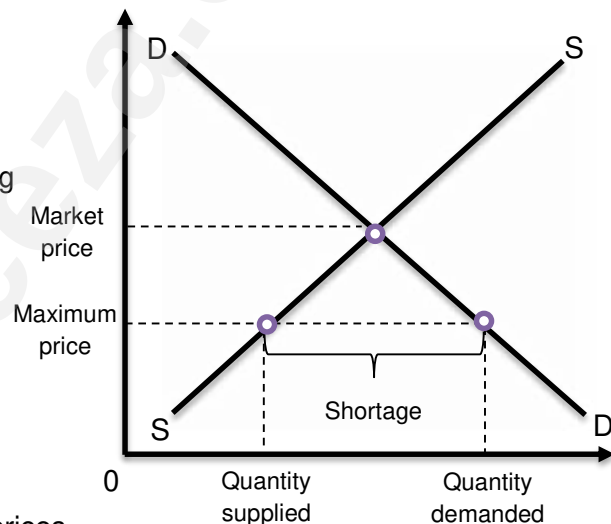
Minimum Prices:

- ❖ It is known as minimum price or price floor when the government sets a minimum legal limit of a price of a particular good or service.
- ❖ For this to have an effect on market, the price floor must be placed above the natural market price.
- ❖ This normally leads to a surplus – the quantity supplied will be greater than the quantity demanded.
- ❖ Price floors are set by the government for certain commodities and services that it believes are being sold in an unfair market with too low of a price and thus their producers deserve some assistance.
- ❖ This is done to enable producers to make a comfortable profit and thus encourages them to supply important essential goods.



Maximum prices:

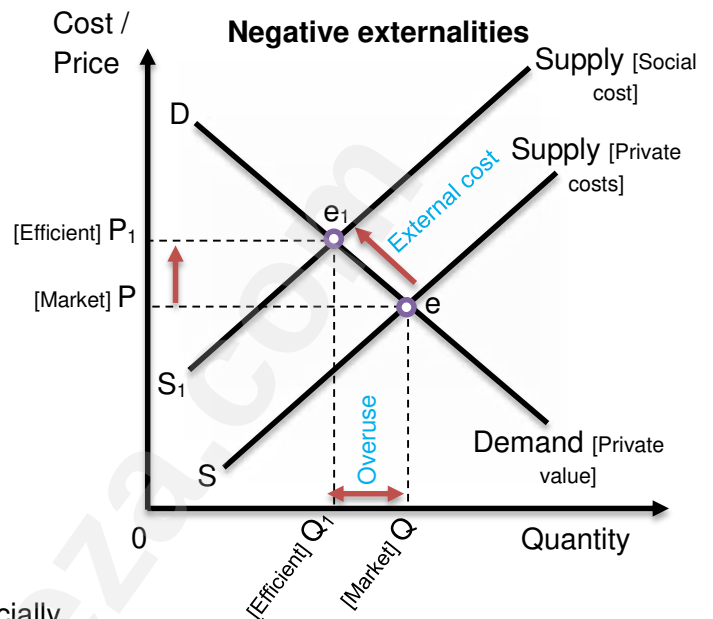
- ❖ It is known as maximum price or price ceiling when the government sets a maximum legal limit of a price of a particular good or service.
- ❖ For this to have an effect on market, the price ceiling must be placed below the natural market price.
- ❖ This normally leads to a shortage – the quantity demanded will be greater than the quantity supplied.
- ❖ If a government decides that the market clearing price of a good or service is too high and needs to be reduced, a price ceiling may be imposed.
- ❖ The reasons for such an intervention could be:
 - ✚ A monopoly which charges unreasonably high prices.
 - ✚ The good or service is an essential or it is a merit good, e.g. education.



Taxes and subsidies:

Taxes:

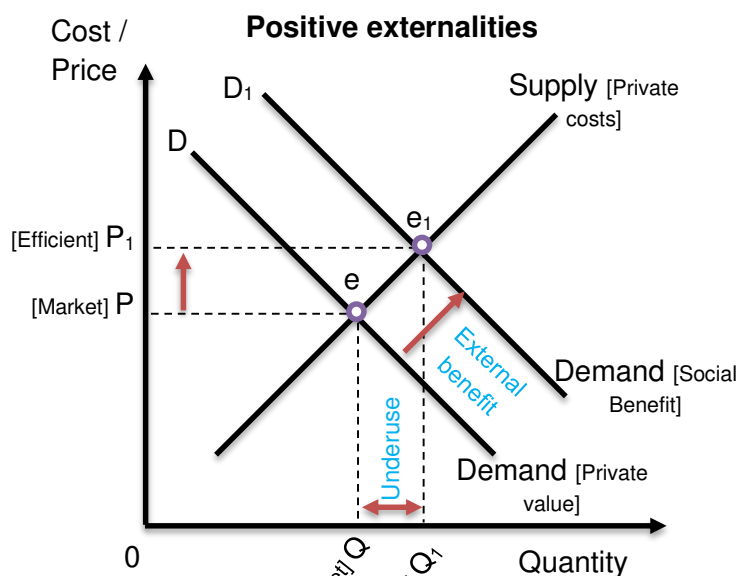
- ❖ Government can intervene in the market by levying taxes to recover the external cost.
- ❖ These taxes will increase the price and will result in a decrease in production.
- ❖ This could help to reduce a negative externality such as pollution.
- ❖ The graph on your right shows negative externalities.
- ❖ The price charged at market equilibrium point e is P and quantity Q is sold.
- ❖ This represents **private cost**.
- ❖ If external costs could be quantified and then added, e_1 (efficient equilibrium) would become the new equilibrium, P_1 becomes the new price and quantity sold reduces to Q_1 .
- ❖ As a result of this negative externality, quantity produced becomes less but the price charged becomes more.
- ❖ Note: e represents private costs whilst e_1 represents private + social costs.
- ❖ Private costs + external costs = social costs
- ❖ In case of negative externalities, free markets fail because they produce more than required of a socially harmful good such as alcohol.
- ❖ **Solution** would be charging an excise duty (sin tax) on goods that have an external cost, which will reduce consumption.
- ❖ A typical example is sin tax charged on cigarettes.



Subsidies:

- ❖ The government provides subsidies to producers in order to encourage them to increase the production of goods.
- ❖ Subsidies increase supply.
- ❖ Producer subsidies are often given to suppliers of agricultural products such as milk, wheat and maize.
- ❖ Subsidies lower the cost of producing goods and thus the market price of these goods is lowered thereby increasing consumption of the subsidised good or service.

- ❖ The graph on your right shows positive externalities.
- ❖ The price charged at point e (market equilibrium) is P and quantity Q is sold.
- ❖ This represents private benefit.
- ❖ If external benefits could be quantified and then added, e_1 (efficient equilibrium) would become the new equilibrium and P_1 becomes the new price and quantity sold increases to Q_1 .
- ❖ Line DD represents private benefits, line D_1D_1 represents social benefit, line SS represents direct cost for providing a good/service.
- ❖ Point e is the market equilibrium.



- ❖ Private benefit + external benefit = **social benefits**
- ❖ In case of positive externalities, freely operating markets fail because they provide less than the required quantity of a socially useful product e.g. education.
- ❖ Solution would be paying a subsidy that is equal to the external benefit, which will increase consumption of merit goods.
- ❖ A typical example is education subsidy.

Redistribution of wealth:

- ❖ The South African government uses taxing (progressive income tax system) and spending powers to redistribute income and wealth
- ❖ Traditional methods e.g. the levying of various taxes and the provision of free services, services in kind and cash benefits to the poor.
 - ✚ Implementing Redress methods e.g. the use of law to enforce redistribution.
 - ✚ It includes BEE, affirmative action, empowerment, land restitution, land redistribution and property subsidies (for RDP houses).

Government involvement in production:

- ❖ When government gets involved in the production of goods, more merit goods are produced and less demerit goods are produced.
- ❖ **Merit goods:** these goods can be subsidised to increase consumption. **Examples**, free health care, collecting refuse and litter, free education
- ❖ **Demerit goods:** these goods can be taxed to reduce consumption. **Examples** include, tobacco, alcoholic beverages, recreational drugs, gambling, etc. Note: a good with negative externalities (e.g. driving a car) isn't necessarily a demerit good. Driving a car causes pollution (negative costs to other people, but it cannot be classed as a demerit good.
- ❖ **Public goods:** Since public goods and services are non-excludable and non-rivalry, the market is not willing to supply them. As a result, government can do so or outsource the production thereof and finance this by raising taxes

TOPIC:

ECONOMIC GROWTH AND DEVELOPMENT

13. Discuss in detail the supply-side approach in promoting growth and development in South Africa
 Give an overview of the supply-side approach: [*Efficiency and effectiveness of markets - Business efficiency - The cost of doing business - The factors of production (natural resources, human resources, capital, entrepreneurship, technology)*]

The supply-side approach to growth and development

- ❖ The supply factors can contribute to economic growth by an increase in resources, such as natural resources, labour, capital and entrepreneurship and an increase in efficiency with which such resources are used.
- ❖ The supply-side approach focuses on the expansion in the production capacity of the economy.
- ❖ The South African government uses the supply-side approach complementing or in addition to a demand-side approach.

Efficiency and effectiveness of markets

- ❖ **Efficiency:** Both productive and allocative efficiency lead to an increase in output by efficiently making use of resources.
- ❖ Perfect markets tend to be more efficient than imperfect markets due to competition.
- ❖ **Effectiveness:** If businesses accomplish their aims, (profitability and growth), the business is effective.

Business efficiency

- ❖ Business efficiency is how much output a business produces for a unit of input.
- ❖ Some measures serve as incentives to increase efficiency while others assist in establishing and improving efficiency.
- ❖ The promotion of greater competition serves as an incentive for new businesses to enter the market.
- ❖ Since 1994 many barriers to international trade have been lifted, which has led to a significant increase in competition.
- ❖ The Competition Act (1998) is aimed at limiting the number of monopolies formed, and reducing or eliminating the power of monopolies.
- ❖ The act led to the establishment of the Competition Commission, the Competition Tribunal and the Competition Appeal court.
- ❖ The end result is greater output / supply.

The cost of doing business

- ❖ In South Africa government controls most physical infrastructure components.
- ❖ The availability and cost of infrastructure services play an important role in the financial viability and profitability of businesses:
 - ✚ **Transport costs:** transport options in air, road, rail and sea are available. Government controls air and sea transport in South Africa. Government has committed to improving the efficiency and reliability of its rail transport services and to make it more affordable
 - ✚ **Communication costs:** communication options are in cable, signal and mail. Government controls cable (land or fixed lines) and mail communication services. Cable communication services in South Africa is one of the most expensive in the world but reasonably efficient. High costs make IT services for businesses and individuals expensive and inhibits global competitiveness

The factors of production

- ❖ For the expansion in the production capacity of an economy to take place, an increase in the quality or quantity of the following factors is required:

Natural resources;

- ❖ Natural resources play an important part in the production process and therefore must be protected so that sustainability is ensured.
- ❖ The extraction of these resources must also be efficient.
- ❖ When natural resources are available, manufacturers are able to produce because raw materials will be available.
- ❖ Therefore, ensuring that raw materials are available is a supply-side approach to economic growth and development.

Human resources;

- ❖ Better education and training to improve skills, flexibility and mobility help increase aggregate supply.
- ❖ Spending on education and training is likely to improve labour productivity and is an essential supply side policy option, and one favoured by the South African government.
- ❖ A government may spend money directly or provide incentives for private suppliers to enter the market.
- ❖ Government may also set and monitor standards of teaching and force schools to include a skills component in their curriculum.
- ❖ If human resources are well skilled, output increases due to high levels of productivity, and therefore it is a supply-side approach to economic growth and development.

Capital;

- ❖ Capital formation / investment spending is of paramount importance because without capital, production is mostly impossible, e.g. a human cannot cut down a tree with bare hands. He will need a specific tool and that tool is capital, *[the acquisition of the tool is called **capital formation**]*.
- ❖ The primary, secondary and tertiary sectors all need capital to produce required output.
- ❖ Both government and businesses must continually increase capital formation.
- ❖ This will lead to an increase output, and therefore it's a supply-side approach to economic growth and development.

Technology

- ❖ Technology is the collection of techniques, skills, methods, and processes used in the production of goods and services.
- ❖ Due to technology, communication is rapid, travel is fast, movement is easy, action is quick. As a result, goods that used to take hours to produce now make take seconds.
- ❖ If a country focuses on improvements in technology, production becomes more efficient and therefore it is a supply-side approach to economic growth and development.

TOPIC:

ECONOMIC GROWTH AND DEVELOPMENT

14. Discuss in detail the demand-side approach in promoting growth and development in South Africa
 Give an overview of the demand-side approach: [*The monetary policy (interest rate changes, open market transactions, moral suasion) - The fiscal policy (progressive personal income tax, wealth tax, cash benefits, natural benefits, other redistribution, land restitution and redistribution, subsidies on property)*]

Demand-side policies to stimulate economic growth and development

- ❖ A demand-side approach includes changes in monetary and fiscal policies with the aim of increasing the level of aggregate demand.
- ❖ Monetary policy is executed by the South African Reserve Bank's Monetary Policy Committee
- ❖ It aims to stabilise prices by keeping inflation within 3% and 6%
- ❖ Fiscal policy is executed by the National Treasury / Ministry of Finance.
- ❖ It aims to facilitate government, political and economic objectives
- ❖ A demand-side approach to economic growth and development does not only depend on fiscal and monetary policy
- ❖ It is dependent on all components of aggregate demand, that is C, G, I and X.

Monetary policy:

- ❖ The South African Reserve Bank (SARB) as the central bank in South Africa executes the monetary policy.
- ❖ They use the following instruments:
 - + **Interest rate changes**
 - It is used to influence credit creation by making credit more expensive or cheaper.
 - The exchange rate is stabilised by encouraging inflow or outflows
 - + **Open market transactions**
 - To restrict credit the SARB sells securities.
 - When banks buy these securities money flows from banks to the SARB.
 - The banks have less money to lend and cannot extend as much credit as before.
 - To encourage credit creation the SARB buys securities.
 - Money flows into the banking system.
 - + **Moral suasion**
 - The SARB consults with banks to act in a responsible manner based on the prevailing economic conditions Cash reserve requirements
 - Banks are required to hold a certain minimum cash reserve in the central bank.
 - Banks have a limit amount to give out as credit

Fiscal policy:

- ❖ South Africa's fiscal policy is put into practice through the budgetary process
- ❖ The main purpose of fiscal policy is to stimulate macroeconomic growth and employment, and ensure redistribution of wealth.
- ❖ The following instruments are used:
 - + **Progressive personal income tax:**
 - Higher income earners are taxed at higher tax rates.
 - These taxes are used to finance social development.
 - The poor benefit more than those with higher incomes
 - + **Wealth taxes:**
 - Properties are levied (taxed) according to their market values.
 - Transfer duties are paid when properties are bought.

- Securities (shares and bonds) are taxed when traded.
- Capital gains tax is levied on gains on the sale of capital goods (e.g. properties, shares)
- Estate duties are paid on the estates of the deceased
- These taxes are used to finance development expenditures which benefit the poor more often

Cash benefits

- Old age pensions, disability grants, child support and unemployment insurance are cash grants
- These are also known as social security payments

Benefits in kind:

- These include the provision of healthcare, education, school meals, protection
- When user fees are charged, poor or low income earners pay less or nothing.
- Limited quantities of free electricity and water are provided

Other redistribution:

- Public works programmes, e.g. the Strategic Integrated Projects (SIP), provides employment subsidies and other cash and financial benefits such as training, financing and export incentives

Land restitution and land redistribution:

- Land restitution is the return of land to those that have lost it due to discriminatory laws in the past
- Land redistribution focuses on land for residential (town) and production (farm) for previously disadvantaged groups
- The money for these programmes is provided in the main budget

Subsidies on properties:

- It helps people to acquire ownership of fixed residential properties e.g. government's housing subsidy scheme provides funding to all people earning less than R3 500 per month

TOPIC:

INDUSTRIAL DEVELOPMENT POLICIES

15. Discuss in detail regional development in South Africa in terms of the following benchmark criteria
 Free market orientation - Competitiveness - Sustainability - Good governance - Provisioning of resources - Investment of social capital - Integration - Partnerships

Regional development

Regional development is the **provision of aid** and other **assistance to regions** which are **less economically developed**. Regional development may be **domestic** or **international** in nature. The implications and scope of regional development may therefore vary in accordance with the definition of a region, and how the region and its boundaries are perceived internally and externally.

International best practice for regional development

❖ Free market orientation

- ✚ Government intervention in markets should be kept to a minimum so that the forces of supply and demand, as well as profit motives can allow for efficient allocation of resources.
- ✚ The government must support entrepreneurship on a larger scale, as well as small business development.

❖ Competitiveness:

- ✚ Industries or businesses established as a result of regional policies should be competitive and not need ongoing financial aid from government.
- ✚ Development should not only be limited to labour-intensive production methods, but must also focus on access to technology and the transfer of skills.

❖ Sustainability:

- ✚ The capacity of a region to support its own development and the natural resources and human resources of the region should be harnessed so that employment and sustainable development is achieved.
- ✚ The use of local resources will also offer the most cost-effective solutions.
- ✚ The people from a specific region should strive to be independent and allow development to take place from within.

❖ Good governance:

- ✚ Regional development strategies should be managed effectively and be free of corruption.
- ✚ Principles of accountability and transparency should be applied to ensure financial control.
- ✚ Projects should be correctly programmed, monitored and evaluated.

❖ Provision of resources:

- ✚ Sufficient resources should be provided in resource-poor areas, such as the development of infrastructure.
- ✚ The interaction of all aspects of a community such as health, education and nutrition must be considered.

❖ Investing in social capital:

- ✚ Governments need to improve the quality of education and healthcare in a region.
- ✚ Development for people involves providing essential services and goods that improve the living standard of people in a region.
- ✚ Examples include food, housing and security.

❖ Integration:

- ✚ An integrated approach should be followed, ensuring that benefits on one part of a region spill over to other industries and areas.
- ✚ (Examples of an integrated approach should focus on tourism, agriculture, etc.)

❖ **Partnerships:**

- ✚ Partnerships should be built between central government, local authorities, civil society, special interest groups, NGO's and the private sector.
 - The private sector, the public sector and local communities must cooperate with one another to achieve the best possible regional development.
 - The private sector provides investment, expertise and goods in the development process.

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TOPIC:

INDUSTRIAL DEVELOPMENT POLICIES

16. Discuss in detail South Africa's initiatives (endeavours) in regional development

South Africa's endeavours

Spatial Development Initiative (SDIs)

SDI refers to national government initiative programme aimed at unlocking inherent and underutilized economic development potential of certain specific spatial locations in SA / regional development initiative in SA to attract infrastructure and business investments to neglected and underdeveloped areas. SDIs are regional strategies that are led by either **local** or **provincial government**. The **Department of Trade and Industry** (DTI) is the main driver of both SDIs and IDZs in collaboration with other bodies such as **Department of Water Affairs and Forestry** (DWAF), the **Industrial Development Corporation** (IDC), and parastatals such as **Eskom** and **Telkom**.

- ❖ SDIs are **links between economic hubs** and regions in a country and these links provided by SDIs are known as **growth corridor**
- ❖ Involves **strategic initiatives** by government and its key objectives are:
 - + **Stimulate economic activity** in selected strategic locations throughout SA
 - + **Generate economic growth** and foster sustainable industrial development
 - + **Create long-term employment** in underdeveloped areas with high poverty and unemployment
 - + Develop projects of infrastructure in certain areas and finance them by way of lending and private sector investment
 - + Develop the inherent economic potential of certain areas
 - + Ensure rapid planning and delivery
 - + Restructure the apartheid-space economy
 - + Maximize various types of private sector investment
 - + Exploit SA underutilized location and economic advantages for export-orientated growth of SDIs
 - + Establish private—public partnerships (PPPs)
- ❖ To foster sustainable industrial development in areas where poverty and unemployment are the highest, the **SDI** focuses on:
 - + High-level support in areas where socio-economic conditions require concentrated government assistance
 - + Where inherent economic potential exist

Aims of SDIs

- ❖ To stimulate economic growth and employment
- ❖ To use economic projects to stimulate economic growth
- ❖ Fast-track investment

As of 2014, there are 11 SDIs in SA. Below is a list of the 11 **SDIs** and their economic areas:

1. **KwaZulu-Natal SDI** – Industrial
2. **Wild Coast SDI** – Agri-tourism
3. **Fish River SDI** – Industrial - including East London
4. **West Coast Investment Initiative** – Industrials and agri-processing - Saldanha – Minerals and metals especially steel
5. **Coast-to-Coast Corridor** – Transport and tourism - Walvis Bay (Namibia) through Johannesburg to Maputo
6. **Platinum SDI** – Industrial and agri-processing - Rustenburg
7. **Phalaborwa SDI** – Industrial and agri-tourism - Phalaborwa

8. **Gauteng Special Economic Zone** – Information technolog, telecommunication
9. **Maputo Development Corridor** – Industrial and agri-processing - from gauteng through Mpumalanga to Maputo (Mozambique) – mining, tourism and transport.
10. **Lubombo SDI** – Agri-tourism - from St Lucia along the coast to Port do Quro (Mozambique)
11. **Richards Bay Initiative** – Mining and agri-processing - including Durban and Pietermaritzburg – Minerals and metals especially aluminium, auto-components and subtropical fruit

Industrial Development Zone (IDZs)

- ❖ Industrial development refers to policies that are aimed at **encouraging industrial investment** and greater industrial efficiency
- ❖ IDZs are **geographically designed, purpose-built industrial sites** providing services tailored for export-orientated industries.
- ❖ **Physically enclosed and linked to an international port or airport.**
- ❖ Specifically designed to **attract new investment** in **export-driven industries.**
- ❖ **Falls 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.
- ❖ Government IDZ policy designed to **boost exports** and **jobs.**
- ❖ IDZs aim to **encourage economic growth** – attract **foreign investment in industrial development** – facilitate **international competitiveness** regarding manufacturing.

Aims of the IDZ in the SA economy:

- ❖ **Increase exports** by **encouraging manufacturing** and **foreign trade**
- ❖ To **strengthen surrounding economies** by utilising local banks, residential areas and shops
- ❖ Increase employment
- ❖ Raise the **standard of living**
- ❖ Attract new investment in export-driven industries.
- ❖ Encourage **economic growth** by attracting foreign investment in industrial development.
- ❖ Duty free importation of production-related raw materials and inputs.
- ❖ A zero rate of VAT on supplies procured from South African sources.
- ❖ Government incentive schemes.
- ❖ Reduced taxation and exemption for some activities or products.
- ❖ Enhance competitiveness of local industries (immediate environment)
- ❖ Promote and develop links between domestic and zone-based industries
- ❖ Enable exploitation of resource-intensive industries

Examples of IDZs:

- ❖ As of 2014, South Africa has six disignated **Industrial Development Zones** (IDZs), namely
 1. **Coega** near Port Elizabeth (steel and automobile components),
 2. **East London** (automotive and general manufacturing),
 3. **Richards Bay** (metals),
 4. **OR Tambo Intenational Airport** (high-tech industries),
 5. **Saldanha Bay** (steel) and the recently designated
 6. **Dube Trade Port IDZ**

Special Economic Zone (SEZs)

- ❖ Special economic zones can be defined as a **geographically demarcated area** where **specific economic activities** have been identified to be developed. These areas may then enjoy **incentives** such as **tax relief** and **support systems** to promote industrial development.
- ❖ There are many categories of **SEZs** and in many instances different countries use different terminology. The following categories have been identified:

- ✚ **A free port:** this is an area which borders a port of entry (seaport and airport) where imported goods are exempted from customs duties. When these goods move from the “free” area to a non-free area in the country, they are subject to import duties.
- ✚ **Free trade:** part of an area where goods are not subject to the usual customs control such as import duty and taxes.
- ✚ **Industrial parks:** infrastructure such as buildings set aside for the sole use of production and business services that will focus on attracting new businesses.
- ✚ **Science and technology:** infrastructure set aside for development of knowledge-based businesses that are linked to institutions such as universities. Normally it incorporates business management and other services, and a technology link to the institution.
- ✚ **Sector development zones:** areas that focus on specific industries

Corridor

- ❖ A corridor is a track of land that forms a passageway allowing access from one area to another and particular advantages to mining, manufacturing and other businesses
- ✚ Domestic corridor
 - e.g. Lubombo, West Coast, Fish River
- ✚ Corridors beyond the South African borders (SADC)
 - e.g. Maputo Development Corridor, Mozambique.

The Maputo Corridor Road Distances



Reasons in support of South Africa's regional integration in Southern Africa:

- ❖ have political and stable neighbours - have important export markets and a future source of water and energy supplies
- ❖ integration may be a precondition for support from foreign investors, donors and multilateral institutions
- ❖ a robust regional transport system and a solid infrastructure base hold the key to attracting investment into the SADC region
- ❖ improving competitiveness and promoting trade.

Advantages from corridor development:

- ❖ greater levels of economic efficiency and productivity
- ❖ compact urban form
- ❖ corridor developments will often occur due to private investment
- ❖ integration of land use and transport planning will lead to generally efficient integration
- ❖ efficient urbanization leads to efficient use of land and promotion of efficient transport system

Incentives to promote industrial development

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 (FIG)

- ❖ 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.

TOPIC:

ECONOMICS AND SOCIAL PERFORMANCE INDICATORS

17. Discuss in detail the following economic indicators:

*Production indicators [Nominal GDP - Real GDP - Per capita GDP] - Inflation rate indicators [Production prices (PPI) - Consumer prices (CPI)] - Foreign trade indicators [Terms of trade - The exchange rate] - Employment indicators [Economically active population (EAP) - Employment rate - Unemployment rate] - Productivity indicators [Labour productivity - Remuneration per worker] - Interest rate indicators [Repo rate] - Money supply indicators [M1 - M2 - M3]

Economic indicators

- ❖ There are 6 key economic indicators:
- ❖ The **MNEMONIC** (acronym used to aid recall) for economic indicators is: *People Pay Money For Every Purchase*.
 - ✚ People: **P**roduction indicators
 - ✚ Pay: **P**rice change indicators
 - ✚ Money: **M**onetary change indicators
 - ✚ For: **F**oreign trade indicators
 - ✚ Every: **E**mployment indicators
 - ✚ Purchase: **P**roductivity indicators

Production Indicators

Real GDP / GDP @ constant prices

- ❖ When the national accounts are compiled, the national accountants have to use the prices ruling at that time (i.e. current prices).
- ❖ However, when one year's figures are compared with another year's figures, the existence of inflation has to be taken into account.
- ❖ National accountants distinguish between nominal production and income and also between real production and income.
- ❖ This is achieved by expressing the value of production or income (e.g. GDP) at the prices that applied during a base year.
- ❖ This is called measurement at constant prices.
- ❖ If each year's GDP is expressed at the same constant prices, it follows that changes from one year to the next are the result of real growth (not inflation).
- ❖ Economic growth is thus calculated on the basis of real GDP (not nominal GDP).
- ❖ In other words, GDP at constant prices serves as the basis for calculating economic growth.
- ❖ GDP at current prices cannot be used since it includes the impact of inflation.
- ❖ That is why most national accounting data are published at constant prices as well as at current prices.

Nominal GDP / GDP @ current prices

- ❖ Current prices measure GDP using the actual prices that we notice in the economy.
- ❖ It uses nominal prices i.e. effects of inflation are not catered for.
- ❖ **Example:**

Year	GDP @ current prices	Price level	GDP @ constant prices
2014	100	100	100
2015	105	102	103
2016	109	104	105
2017	114	106	108

- ❖ This shows that between 2014 and 2017, GDP @ current prices rose by 14%.
- ❖ However, in this period, inflation was 6%.
- ❖ Therefore, adjusting for effects of inflation, GDP has increased in real terms by 8%.
 - ✚ At current prices, (considering inflation) GDP rose by 14%
 - ✚ At constant prices (ignoring inflation) GDP rose 8%

Per capita real GDP

- ❖ It represents the standard of living
- ❖ Calculated as follows:
$$\frac{\text{Real GDP}}{\text{Population of a country}}$$
- ❖ It shows real productivity of the population
- ❖ Per capita real GDP figures are used for:
 - ✚ Comparing the standard of living between countries
 - ✚ Indicating the importance of the different sectors in the economy
 - ✚ Comparing the standard of living between different groups within a population
- ❖ **SA's GDP per capita**
 - ✚ **2010:** (USD 7 176) **2011:** (USD 7 831) **2012:** (USD 7 314) **2013:** (USD 6 618)
- ❖ **USA's GDP per capita**
 - ✚ **2010:** (USD 48 377) **2011:** (USD 49 803) **2012:** (USD 51 496) **2013:** (USD 53 042)

Price Change Indicators

Responsible for inflation. Inflation is defined as a sustained increase in the general price level and a decrease in the purchasing power of money

Consumer Price Index (CPI)

- ❖ This is the official index used in inflation targeting
- ❖ CPI show price changes of a representative basket of goods and services that consumers buy.
- ❖ The index covers metropolitan and other urban areas.
- ❖ It is an overall index and the weights are obtained from the expenditures of different income categories of households.
- ❖ It is the most comprehensive indicator measuring consumer inflation in South Africa.
- ❖ It shows changes in the general purchasing power of the rand.
- ❖ Interest rates are the main monetary instrument used by SARB to fight inflation
- ❖ As of 5 July 2017, CPI was at 5.4% year on year.

Producer Price Index (PPI)

- ❖ PPI measures the cost of production rather than the cost of living/consumption
- ❖ Basket consist of goods only
- ❖ Capital and intermediate goods are included
- ❖ Prices exclude Value Added Tax (VAT)
- ❖ Interest rates are excluded
- ❖ Prices of imported goods are shown explicitly
- ❖ As of 5 June 2017, PPI was at 4.8% year on year.

Monetary Change Indicators

Money supply

The money supply is controlled by SARB and it is classified into 3 categories namely M1, M2 & M3

- ❖ The money supply is the responsibility of the SARB.
- ❖ It is important to give early warning of likely changes in inflation.
- ❖ The SARB defines the quantity of money to consist of three aggregates:
 - ✚ **M1** – includes coins and notes and demand deposits for the domestic private sector with monetary institutions. (**M1 June 2015:** 1 315 412, which is 9,44% increase over 1 year)

- ✚ **M2** – is equal to M1 plus all other short-term and medium-term deposits of the domestic private sector with monetary institutions. (**M2 June 2015:** 2 305 254, which is 8,9% increase over 1 yr)
- ✚ **M3** – is equal to M2 plus all long-term deposits of the domestic private sector with monetary institutions. (**M3 June 2015:** 2 867 036, which is 8,89% increase over 1 year)

The Repo Rate

- ❖ This is the interest rate charged by the Central Bank (SARB) to commercial banks and it serves as the benchmark for the other interest rates in the economy.
- ❖ As of 5 July 2017, the Repo rate was at 7% per annum.

Prime Interest Rate / Prime Rate / Prime lending rate

- ❖ This is the interest rate charged by commercial banks when it lends money to other banks or individuals
- ❖ The prime rate is **always** higher than the **repo rate** so that commercial banks can be able to recover (pay back) the repo rate
- ❖ As of 5 July 2017, the prime lending rate was at 10.5%.

Foreign Trade Indicators

- ❖ International trade is important for the purposes of Globalisation:

The terms of trade

- ❖ This is the ratio of export price to import price. Changes in the terms of trade may be followed by a change in the balance of payments

The exchange rate

- ❖ The exchange rate is the price of one currency in terms of another currency. If the exchange rate changes, this will influence the price of imports and exports. Importers and exporters therefore monitor the exchange rates of the currencies of the countries with which they trade.

Employment Indicators

These are counter-cyclical indicators:

Full Employment

- ❖ Full employment refers to aim of providing everyone who is willing to work at current wage rate with a job
- ❖ Increase employment to decrease loss of production – produce more goods and services

Economically Active Population (EAP)

- ❖ Unemployment is calculated by expressing number of people who are willing and able to work, but do not have a job, as a percentage of the total number of people that are willing and able to work (EAP).
EAP: people between 15 and 60/65

Unemployment

- ❖ The proportion of EAP that are actively looking for work but are not working
- ❖ Unemployment is currently (5 July 2017) at 27,7%

Employment Rate

- ❖ Employment rate is the proportion of the **Economically Active Population** (EAP) that are working
- ❖ It is calculated by expressing the number of employed people as a percentage of the EAP / labour force participation rate
- ❖ Employment is important for the forecasting of trends – employment in the various sectors
- ❖ SA employment rate was ± 75% in 2005 – low compared to rates in developed and some developing countries
- ❖ Growth in the economy is not accompanied by similar growth in employment numbers
- ❖ Employment indicators are used for three purposes:

- ✚ To calculate trends in employment in different sectors or industries; to disclose structural changes in economy
- ✚ To calculate productivity
- ✚ To show success of economy in utilising its full potential
- ❖ An increasing demand for highly skilled labour while there is an oversupply of low skilled labour
- ❖ Average wage increases that are higher than the inflation rate
- ❖ The strong presence and influence of trade unions in the economy
- ❖ Labour unrest, strikes and work stoppages which cause a loss in number of days work
- ❖ Restructuring of the economy and introduction of new international competitiveness of domestic producers, which has led to layoffs of low skilled workers

Productivity Indicators

Productivity is an average measure of the efficiency of production. It can be expressed as a ratio of output to inputs used in the production process, i.e. output per unit of input. When all outputs and inputs are included in the productivity measure it is called total productivity.

Labour productivity

It measures the amount of goods and services produced by one hour of labour. More specifically, labour productivity measures the amount of real GDP produced by an hour of labour. Growing labour productivity depends on three main factors: investment and saving in physical capital, new technology and human capital.

For example, suppose the real GDP of an economy is R10 trillion and the aggregate hours of labour in the country is 300 billion. The labour productivity would be R10 trillion divided by 300 billion hours, equalling about R33 per labour hour. Growth in this labour productivity number can usually be interpreted as improvements or rising standards of living in the country

TOPIC:

ECONOMIC AND SOCIAL PERFORMANCE INDICATORS

18. Discuss in detail the following social indicators:

Demographic indicators [*Population growth - Life expectancy*] - Nutrition and health indicators: Nutrition [*Malnutrition – Obesity*] Health [*Child mortality - Under 5 mortality - Spending on health - Access to clean water - Access to sanitation*] - Education [*Percentage public-sector spending - Percentage enrolment in secondary schools*] - Services [*Electricity - Refuse/Garbage removal - Water supply – Sanitation*] - Housing and urbanisation: Housing [*Number of houses completed*] Urbanisation [*Natural growth in population - Migration - Founding of new towns*]

Social indicators

- ❖ Social indicators are statistics that measure the level of social development and human welfare within a country. There are 6 Social Indicators:
- ❖ The **MNEMONIC** (acronym used to aid recall) for social indicators is: **DIEHUN**
 - ✚ D: **D**emographic indicators
 - ✚ I: **I**ncome indicators
 - ✚ E: **E**ducation indicators
 - ✚ H: **H**ousing indicators
 - ✚ U: **U**rbanisation indicators
 - ✚ N: **N**utrition indicators

Demographic Indicators

Population growth

- ❖ Measuring of population growth is done through conducting a census. We need to know the population of the country for service delivery purposes and also to establish a tax base.
- ❖ South Africa has a relatively high population growth rate compared with developed countries
- ❖ A high population growth coupled with low economic growth harms efforts to improve the average standard of living of the population
- ❖ It also places great pressure on government finances in terms of providing social services

Life expectancy

- ❖ It is the number of years a new born infant is expected to live.
- ❖ Life expectancy is higher in developed countries than it is in developing countries.
- ❖ **South Africa's life expectancy: 2010:** (54 years), **2011:** (55 years), **2012:** (56 years)
- ❖ **USA's life expectancy: 2010:** (78,5 years), **2011:** (78,6 years), **2012:** (78,7 years)

Income Distribution Indicators

Head Count Index

- ❖ The World Bank states that everyone living on less than a US\$1.25 a day is living below the poverty datum line
- ❖ Poverty headcount ratio at national poverty line (% of population) in South Africa was reported at 22 in 2008, according to the World Bank.

Gini-coefficient

- ❖ It ranges between 0 – 1. The higher the value the more unequal the distribution of income.
- ❖ Progressive income taxing and BEE are methods used to lower the Gini-coefficient
- ❖ In SA, the Gini-coefficient was 0,65 in 2011 and in the US it was at 0.41 in the same year

Education

- ❖ **Literacy rate:** A higher ratio of literacy, knowledge and skills among the population is necessary.
- ❖ This can be achieved by means of effective and appropriate education and training.
- ❖ This will ultimately lead to increased productivity, competitiveness, national wealth and a higher standard of living per capita of the population.
- ❖ Spending on education makes up the largest percentage of total government expenditure in South Africa and is clearly a priority. Currently (August 2015), literacy rate is at 92,9% in SA

Housing and services

- ❖ **Housing:** A significant proportion of South Africans are poor and cannot afford to buy residential property.
- ❖ The government facilitates home ownership by means of a subsidy system and loans from the private sector.
- ❖ Factors hindering housing delivering and home ownership in South Africa include: high levels of unemployment and a very skew income distribution.
- ❖ **Services:** The General Household Survey was developed to measure the level of development and performance of various government programmes and projects.
- ❖ One of the purposes of the GHS is to measure development indicators in the country e.g. access to basic services such as piped water, electricity, and refuse removal.
- ❖ A number of services are vital to enhance people's lifestyles namely:
 - ✚ **Electricity** – increased from 50% in 1995.
 - ✚ **Refuse disposal** – households in SA has access to refuse removal by local authorities once a week.
 - ✚ **Water supply** – some 86% of households had access to clean water in 2004.
 - ✚ **Sanitation** – some 57.1% of households in SA had access to flush or chemical facilities in 2004.

Urbanisation:

- ❖ Can be described as a worldwide process of transformation whereby communities change from a rural to an urban place of residence.
- ❖ Urban areas are usually faster growing and are normal feature of economic development.
- ❖ More employment opportunities exists, higher wages and other perceptions of a better life in cities.
- ❖ Urbanisation points out to governments and developers that land has to be provided for a variety of purposes and services.

Nutrition & Health Indicators

- ❖ Indicators used both nationally and internationally to monitor the health of a population:

Infant mortality

- ❖ Measured in terms of number of infants who die before reaching one year of age per thousand live births in a given year.
- ❖ **SA's infant mortality rate: 2010: (35), 2011: (34), 2012: (34), 2013: (33) per 1000 live births**

Under-five mortality

- ❖ Measured in terms of probability that a new-born baby will die before reaching the age of five years if subject to present age-specific mortality rates.
- ❖ Probability expressed as number per thousand
- ❖ **SA's under 5 mortality rate: 2010: (53), 2011: (48), 2012: (45), 2013: (44) per 1000 live births**

Health expenditure

- ❖ Measured in terms of amount of public and private health expenditure on health care as percentage of GDP.
- ❖ In 2001 SA's expenditure was 8.6% compared to 10.8 in high income countries.

Access to safe drinking water

- ❖ Measured in terms of percentage of population that has reasonable access to safe drinking water treated or uncontaminated.
- ❖ In 2002 87% of SA population had access compared to 64% in Africa.

Access to sanitation facilities

- ❖ Measured in terms of percentage of population with at least adequate sanitation facilities that can effectively prevent human, animal and insect contact.
- ❖ In 2002 67% of South African population had access to improved sanitation.
- ❖ It's an important indicator for the well-being of infants and young children.
- ❖ Two opposite nutrition conditions are relevant, i.e. child malnutrition and overweight children – both important for children under five years of age.

Child malnutrition

- ❖ Expressed in 2 ways: weight for age (underweight) and height for age (stunting or dwarfism).
- ❖ Proportion of children underweight is most important indicator of malnutrition.
- ❖ Important to monitor weight because being underweight increases the risk of death and inhibits cognitive development in children.

Overweight children

- ❖ Growing concern – there exists an association between obesity in childhood and high prevalence of diabetes, respiratory disease, high blood pressure and psychological and orthopaedic disorders.
- ❖ Being overweight can lead to numerous adverse health conditions which affect people's ability to work and take care of themselves.

TOPIC:

INFLATION

19. Discuss in detail the causes of demand-pull inflation:

Increase in household consumption [*Decline in savings* - *Tax reduction* - *Access to credit*] - Investors' expenditure - Government expenditure - Export services

Causes of Demand-pull / demand inflation

❖ Increase in the money supply

- ✚ A higher increase in the supply of money in circulation in the market than in supply of goods and services.
- ✚ There is more money available to buy the same goods.
- ✚ If the supply of goods does not increase (increase in productivity) sellers will want more money for their goods because buyers are willing to pay more.

❖ Increase in consumption (C)

- ✚ income of households increase at faster rate than aggregate supply
- ✚ **Due to:** Less savings start spending current and accumulated savings
- ✚ Reduction in taxes e.g. personal income tax

❖ Access to credit

- ✚ as interest rate decrease more money is demanded
- ✚ Increase in economic active population has pushed up the demand for many consumer items making more money readily available, e.g. credit cards, overdraft facilities

❖ Investment spending

- ✚ lower interest rates result in improvement in the profit expectations of a business
- ✚ business invests more and may lead to an increase in demand for goods and services part of investment e.g. cement, bricks

❖ Government spending

- ✚ increase without corresponding rise in aggregate supply leads to increase in prices
- ✚ government borrowing money from banks leads to more money in circulation
- ✚ government spends money on infrastructure, consumption spending and social spending
- ✚ Consumers have more money to spend but no goods on which to spend their money

❖ Export earnings

- ✚ foreign growth creates demand for locally produced goods
- ✚ sales of exports increase the money supply in the country which increases demand
- ✚ If exports increase, with no increase in domestic production, fewer goods are available in the country

❖ Commodities demand expands and contracts like business cycles do

- ✚ An increase in the money supply without a corresponding increase in production in proportion to the money supply causes an excess demand
- ✚ Certain causes of demand pull inflation include an increase in the disposable income of households.
- ✚ Availability of credit from banks, credit cards and personal overdrafts, increasing demand.
- ✚ An increase in the economically active population increasing the demand for more consumer goods.

TOPIC:

INFLATION

20. Discuss in detail the causes of cost-push inflation

Wages - Key inputs - Exchange rate depreciation - Profit margins - Productivity - Natural disasters

Causes of Cost-push / cost inflation

Wages:

- ❖ Wage increases that are higher than productivity cause a cost increase for businesses.
- ❖ Wages are the single most important cost item in any economy.
- ❖ Wages contribute to almost 50% of value added to basic prices.

Key inputs:

- ❖ When the price of imported key inputs (e.g. oil) increases, the domestic costs of production also increases.
- ❖ Producers recover these costs by increasing the prices of their products.

Profit margins:

- ❖ When businesses push up their profit margins, they increase the cost of production and the price that the consumers have to pay.
- ❖ This is because manufacturers recover the higher prices they have to pay by increasing their prices

Productivity:

- ❖ If various factors of production become less productive while still receiving the same remuneration, the cost of producing each unit of output increases.
- ❖ This pushes prices up.

Exchange rate depreciation:

- ❖ If the rand depreciates against the major currencies, imports from such countries will be more expensive.
- ❖ Producers have to pay more money for the same quantity of products than before; as such, they often shift the increase to the consumers

Natural disasters:

- ❖ Disasters, such as floods and droughts, affect the cost of production negatively.
- Food prices are one of the most volatile price items as a result of the effect of weather changes

TOPIC:

TOURISM

21. Examine in detail the benefits of tourism

Households - Businesses - State - Infrastructure development

Benefits of tourism

- ❖ The following sectors benefit the most from tourism:
- ❖ The **MNEMONIC** (acronym used to aid recall) for benefits of tourism is: *Hot Sun In Brooklyn*.
 - ✚ Hot: **H**ouseholds
 - ✚ Sun: **S**tate
 - ✚ In: **I**nfrastructure development
 - ✚ Brooklyn: **B**usinesses

Households

Benefit through three main impacts of prosperity:

- ❖ Income – salaries and wages – due to involvement with tourism
- ❖ Infrastructure – available for tourists and local people's use
- ❖ Skills – variety required – education + training required – school subject

State / Government

- ❖ The main avenue for governments to benefit from tourism is through the levying of taxes.
- ❖ These taxes have a dual purpose.
- ❖ To recover external costs
- ❖ This cost is recovered from the tourist through adding the taxes to the supply price / normal expenditure taxes (e.g. VAT, excise duties, customs duties).
- ❖ This amount serves to compensate the host community for providing the infrastructure, public amenities (showers, toilets) to the tourists.
- ❖ Tourists are seen as part of the overall tax base, e.g. through airport departures, air ticket taxes and taxes on hotel rooms

Infrastructure development

- ❖ Adequate and well-maintained physical and basic services infrastructure are essential for tourist destination areas.
- ❖ Economic infrastructure has been prioritised by Department of Tourism e.g. accesses to beaches, lakes and rivers
- ❖ Social infrastructure has also been improved, e.g. ambulance services, medicines, and information services.

Businesses

- ❖ Economic and basic services infrastructure is usually provided by the public sector.
- ❖ A superstructure consists of businesses that provide accommodation, transport, and retailing and recreation services.
- ❖ Tourism also stimulates certain socio-economic objectives such as entrepreneurship development, Black Economic Empowerment and SMME development.
- ❖ They are normally private sector activities and make up the profit-generating element of a tourist destination.
- ❖ A combination of public and private sector finance is used to develop destinations.
- ❖ The public sector also provides a range of financial incentives for private sector tourism investment (grants, subsidies, loans, taxes)

- ❖ There are also many informal and less traditional opportunities for tourism benefits and these serve as stepping stones for previously neglected groups in the tourism business, e.g. car rentals, craft curios sales.

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TOPIC:

TOURISM

22. Examine in detail the effects of tourism

GDP - Employment - Poverty - Externalities - Environment – Investment

Effects of tourism

❖ The **MNEMONIC** (acronym used to aid recall) for effects of tourism is: **GEEPIE**

- ✚ G: **G**DP
- ✚ E: **E**mployment
- ✚ E: **E**xternalities
- ✚ P: **P**overty
- ✚ I: **I**nvestment
- ✚ E: **E**nvironment

GDP [Positive effect]:

- ❖ Biggest impact on services industry than on agriculture or manufacturing
- ❖ Indirect contribution:
 - ✚ tourism is a service-based industry
 - ✚ responsible for 65% of GDP in developed economies and 40% of GDP in developing countries
- ❖ Direct contribution: contribution of 6,8% of GDP compared to 11.6% worldwide.

Employment [Positive effect]:

- ❖ Tourism is the world's largest generator of jobs.
- ❖ Employs 7% of SA workforce (1,12 million)
- ❖ largest provider of jobs and earner of foreign exchange, due to:
 - ✚ Tourism is labour intensive: a lot of actions connected to tourism can only be done by labour and not machines, airport shuttle, hotel services, restaurant services, tour operators, etc.
 - ✚ Tourism employs many skills: all levels of skills are required-unskilled-hotel room cleaners, semi-skilled-bus drivers, skilled-tour guide
 - ✚ Tourism can provide immediate employment
 - ✚ Tourism provides entrepreneurial opportunities

Externalities [Positive effect]

- ❖ Attracts large amounts of revenue, but can cause undue environmental damage (uses resources and produces waste)
- ❖ Global tourism will grow due to increased population, improved living standards, increased free time and expansion of transportation systems
- ❖ Potential: attract revenue to country, alleviate poverty, conserve cultural and natural assets – needs conscious planning
- ❖ Needs to achieve ethical and sustainable tourism must respect tradition and customs of area, plough back earnings into local community – area must be protected as attractive tourist resort.

Externalities [Negative effect]

- ❖ Rapid growth aimed at short-term benefits has more negative than positive effects:
 - ✚ degeneration of traditions and cultural values,
 - ✚ environmental damage to sites and natural settings – pollution and waste
- ❖ Pressure on tourist sites will increase

Poverty [Positive effect]:

- ❖ Tourism is fast and effective distribution mechanism in development of rural areas
- ❖ Prime tourism attractions located in rural areas
- ❖ Promote balanced and sustainable form of development
- ❖ Provides alternative to urbanisation, permitting people to continue - a rural family existence, enfranchising both women and youth
- ❖ Offers diversity of income sources to poor people:
 - + Allowing them a stake
 - + Empowering them
 - + Creating partnerships

Infrastructure [Positive effect]:

- ❖ Adequate physical, economic and basic services infrastructure essential for tourist destinations:
- ❖ Transport infrastructure (roads, railway lines, airports, car parks)
- ❖ Communication infrastructure (telephone lines, electronic signal stations)
- ❖ Energy infrastructure (electricity and liquid fuels)
- ❖ Basic services infrastructure (clean water, refuse removal, sewerage systems).
- ❖ Lack of economic and basic services infrastructure prevents growth of tourism
- ❖ This infrastructure is seen as public investment
- ❖ Seasonality – major problem for infrastructural development

Infrastructure [Negative effect]:

- ❖ Seasonality – major problem for infrastructural development

Environment [Negative effect]:

- ❖ Industrial development has impact on physical environment in which it takes place.
- ❖ Creates environmental stress
- ❖ Categories of environmental stress:
 - + Permanent environmental restructuring (construction work on highways, airports)
 - + Waste product generation (biological and non-biological waste)
 - + Direct environmental stress (destruction of coral reefs)
 - + Effects on population dynamics (migration and urban density, declining rural population)

Other negative effects

- ❖ Lack of respect by other cultures to other traditions/cultural heritages (e.g. Chinhoyi cave in Zimbabwe) this might compromise the site and may affect future visits of other tourists to the site.
- ❖ Cultural degradation
 - Spread of diseases especially during the world cup e.g. HIV/Aids, Ebola and other airborne disease
 - concentration of funds at tourist sites and to uplift social infrastructure at the expense of developing other areas

TOPIC:

ENVIRONMENTAL SUSTAINABILITY

23. Discuss in detail how the government can ensure sustainable development under the following headings:

Grant property rights - Pay for environmental use - Levy environmental tax - Pay environmental subsidies - Issue marketable permits - Command and control - Voluntary agreements – Education

Public sector measures to ensure environmental sustainability

Granting property rights

- ❖ Property rights are legal titles to the ownership, use and disposal of factors of production and goods and services.
- ❖ It ensures that people care for the things that belong to them.
- ❖ (e.g.) Kyoto Protocol where developed countries agreed to provide financial assistance to developing countries because they cause less pollution.
- ❖ The developed countries therefore pay for the right to pollute.

Charging for the use of the environment.

- ❖ The pricing of the environment is one method used by government to impose environmental charges.
- ❖ Government levies a fee on consumers and producers for the waste (solid, liquid, gas) they dump in the environment.
- ❖ Best results are obtained when these charges are proportional to the waste they produce.

Emission charges

- ❖ Government can set a price per unit of pollution.
- ❖ The pollution fee is charged based on the quantity of pollutants released in to the atmosphere.
- ❖ The more pollution the firm creates the more it pays.

Levy environmental taxes

- ❖ A tax could be imposed on the output or consumption of a good, wherever external environmental costs are generated.
- ❖ These are known as green taxes (e.g.) tyres
- ❖ The rate of tax should be equal to the marginal external cost.

Pay environmental subsidies

- ❖ These subsidies reduce activities that cause environmental damage.
- ❖ These costs are recovered from taxation.
- ❖ Subsidies could be for the development of new technology or equipment.
- ❖ Encourage production of environmental friendly subsidies.
- ❖ Encourage recycling of waste such as bottles or cardboards.

Issue marketable permits

- ❖ Governments may wish to charge for the pollution (externality) and it could raise a levy or a tax to pay for it.
- ❖ A licence (credits) or permit is offered, and businesses are allowed to sell their licences to other businesses.
- ❖ Licences or permits or credits are traded in a permit market

Command and control

- ❖ At times government must take direct control
- ❖ This occurs through command and control (CAC) or voluntary agreements or education

Voluntary agreements:

- ❖ These are agreements among the corporate, government and/or non-profit sectors not required by legislation that aim to improve environmental quality or natural resource utilisation.
- ❖ Voluntary agreements represent a new environmental policy approach and have experienced recent growth in many countries and regions.

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TOPIC:

ENVIRONMENTAL SUSTAINABILITY

24. Discuss in detail the following problems and the international measures taken to ensure sustainable development under the following headings:
- Biodiversity - Chemical waste - Hazardous waste - Climate change policy – adaptation and mitigation - Indigenous knowledge

Major international agreements

The world's biggest concerns are the **loss of biodiversity**, **toxic** and **hazardous wastes** and **climate warming**. South Africa is a signatory to a variety of international agreements that deal with environmental issues and environmental sustainability. The World bank, IMF, United Nation strive to achieve the support and cooperation of all countries for their fight against environmental decay

Rio de Janeiro Earth Summit (1992)

- ❖ From 3 – 14 June 1992, **Rio de Janeiro** hosted the United Nations Conference on Environment and development (UNCED).
- ❖ The focus of this conference was the state of the global environment and the relationship between economics, science and the environment in a political context.
- ❖ Purpose of the Earth Summit was to set a series of objectives and establish and sign a number of conventions and treaties to address the deterioration of the global environment.
- ❖ Its main goal was to come up with strategies to stop and reverse the effects of environmental degradation and to support international efforts to promote sustainable development in all countries
- ❖ **Agenda 21** as action plan originated from the Earth Summit
- ❖ **Agenda 21** outlined detail key issues to ensure sustainable development – including issues like resource management, population growth, health and poverty
- ❖ Aimed at the **sustainable development** and the **protection of the environment**.
- ❖ Main value of the summit is that it made countries across the globe aware of the dangers unsustainable development pose to individual countries and the whole world.
- ❖ The threat of environmental problems was widely acknowledged and this led to the reduction of global warming

Kyoto Protocol on Climate Change (1997)

- ❖ The Kyoto Protocol treaty was negotiated in December 1997 at the city of Kyoto, Japan and came into force on 16 February 2005.
- ❖ It is a legally binding agreement under which industrialised countries will reduce their collective emissions for greenhouse gases by 5.2% compared to the year 1990
- ❖ The goal is to lower overall emissions from six greenhouse gases – carbon dioxide, methane, nitrous oxide, sulphur hexafluoride, HFCs, and PFCs – calculated as an average over the five-year period of 2008-2012
- ❖ National targets range from 8% reductions for the European Union and some others to 7% for the US, 6% for Japan, 0% for Russia, and permitted increases of 8% for Australia and 10% for Iceland
- ❖ It is a guide or action plan that sets targets for developed countries to reduce greenhouse gas emissions by 7% before 2010.
- ❖ Signed by 141 nations, including all European and other developed countries USA and Australia
- ❖ To achieve this, countries put controls on the emissions of greenhouse gases by their largest polluters, which are large companies.

Rio+20 summit (2012):

- ❖ The United Nations Conference on Sustainable Development - or Rio+20 - took place in Rio de Janeiro, Brazil on 20-22 June 2012.
- ❖ It resulted in a focused political outcome document which contains clear and practical measures for implementing sustainable development.
- ❖ In Rio, Member States decided to launch a process to develop a set of Sustainable Development Goals (SDGs), which will build upon the Millennium Development Goals and converge with the post 2015 development agenda.
- ❖ The Conference also adopted ground-breaking guidelines on green economy policies.
- ❖ Governments also:
 - ✚ decided to establish an intergovernmental process under the General Assembly to prepare options on a strategy for sustainable development financing.
 - ✚ agreed to strengthen the United Nations Environment Programme (UNEP) on several fronts with action to be taken during the 67th session of the General Assembly.
 - ✚ agreed to establish a high-level political forum for sustainable development. Decisions on its detailed form are expected to be taken during the upcoming session of the General Assembly, with the aim of having the first session of the forum at the beginning of the 68th session of the Assembly.
 - ✚ requested the United Nations Statistical Commission, in consultation with relevant United Nations system entities and other relevant organizations, to launch a programme of work in the area of measures of progress to complement gross domestic product in order to better inform policy decisions.
 - ✚ adopted the 10-year framework of programmes on sustainable consumption and production patterns, as contained in document A/CONF.216/5, and invited the General Assembly, at its sixty-seventh session, to designate a Member State body to take any necessary steps to fully operationalize the framework.
- ❖ The Rio +20 Conference also galvanized the attention of thousands of representatives of the UN system and major groups. It resulted in over 700 voluntary commitments and witnessed the formation of new partnerships to advance sustainable development.

The Millennium Development Goals (MDGs)

- ❖ The Millennium Development Goals (MDGs) are eight international development goals that were established following the Millennium Summit of the United Nations in 2000, following the adoption of the United Nations Millennium Declaration.
- ❖ All 189 United Nations member states at the time (there are 193 currently) and at least 23 international organisations committed to help achieve the following Millennium Development Goals by 2015:
 1. To halve the number of undernourished people
 2. To achieve universal primary education
 3. To promote gender equality and empower women
 4. To reduce child mortality
 5. To improve maternal health
 6. To combat HIV/AIDS, malaria, and other diseases
 7. To help children and make sure that they go to school
 8. To develop a global partnership for development
- ❖ Each goal has specific targets and dates for achieving those targets.
- ❖ To accelerate progress, the G8 finance ministers agreed in June 2005 to provide enough funds to the World Bank, the International Monetary Fund (IMF) and the African Development Bank (AfDB) to cancel \$40 to \$55 billion in debt owed by members of the heavily indebted poor countries (HIPC) to allow them to redirect resources to programs for improving health and education for alleviating poverty.

Evaluation: As of 2013 progress towards the goals was uneven. Some countries achieved many goals, while others were not on track to realise any.

Johannesburg Summit (Rio+10) (2002)

- ❖ In 2002, ten years after the Rio Declaration, a follow-up conference, the World Summit on Sustainable Development (WSSD) was convened in Johannesburg to renew the global commitment to sustainable development.
- ❖ The conference agreed on the Johannesburg Plan of Implementation (JPOI) and further tasked the Commission on Sustainable Development (CSD) to follow-up on the implementation of sustainable development.
- ❖ It was the largest conference ever held in South Africa at that time.
- ❖ It focused on WEHAB – water, electricity, health, agriculture and biodiversity.
- ❖ African environmental issues were also highlighted, namely to improve access to clean water and to help fight the HIV/Aids pandemic.
- ❖ The Summit was very successful with countries committing themselves to a range of actions, namely;
 - ✚ Improving water and sanitation and addressing the causes of ill health.
 - ✚ Poverty eradication
 - ✚ Changing unsustainable patterns of consumption
 - ✚ Globalization
 - ✚ Health
 - ✚ The environment

United Nations Framework Convention on Climate Change:

- ❖ The United Nations Framework Convention on Climate Change (UNFCCC) is an international environmental treaty adopted on 9 May 1992 and opened for signature at the Earth Summit in Rio de Janeiro from 3 to 14 June 1992.
- ❖ It then entered into force on 21 March 1994, after a sufficient number of countries had ratified it.
- ❖ The UNFCCC objective is to "stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system".
- ❖ The framework sets non-binding limits on greenhouse gas emissions for individual countries and contains no enforcement mechanisms.
- ❖ Instead, the framework outlines how specific international treaties (called "protocols" or "Agreements") may be negotiated to specify further action towards the objective of the UNFCCC.

United Nations Climate Change Conference (COP 17) (2011):

- ❖ The United Nations Climate Change Conferences are yearly conferences held in the framework of the United Nations Framework of the United Nations Framework Convention on Climate Change
- ❖ They serve as the formal meeting of the UNFCCC Parties (Conferences of the Parties) (COP) to assess progress in dealing with climate change
- ❖ The **COP 17/CMP 7** was hosted from November 28 to December 9, 2011 in Durban, South Africa
- ❖ The conference agreed to a legally binding deal comprising all countries, which will be prepared by 2015, and to take effect in 2020
- ❖ There was also progress regarding the creation of a Green Climate Fund (GCF) for which a management framework was adopted.
- ❖ The fund is to distribute US\$100 billion per year to help poor countries adapt to climate impacts