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Possible Essays

Economics

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Grade 12



SURNAME: _____ NAME: _____

TEACHER: _____ YEAR: _____

SCHOOL: _____



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

MEMORANDUM:

QUESTION ONE:

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.
- Goods are **tangible items** and they include consumer goods, capital goods, durable, semi-durable and non-durable goods. Examples include computers, paper, bread, etc.
- 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**.
- Households purchase consumer goods for consumption and businesses purchase capital goods for use in the production process.
- **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**.

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**.
- 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 debenture

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.
- The **SARB** is a key institution in the money market.

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]*
3. Discuss in detail the features underpinning forecasting:
 Indicators *[Leading - Coincidence - Lagging - Composite]* Length of a cycle - Amplitude - The trend line
 - Extrapolation - Moving averages

MEMORANDUM:

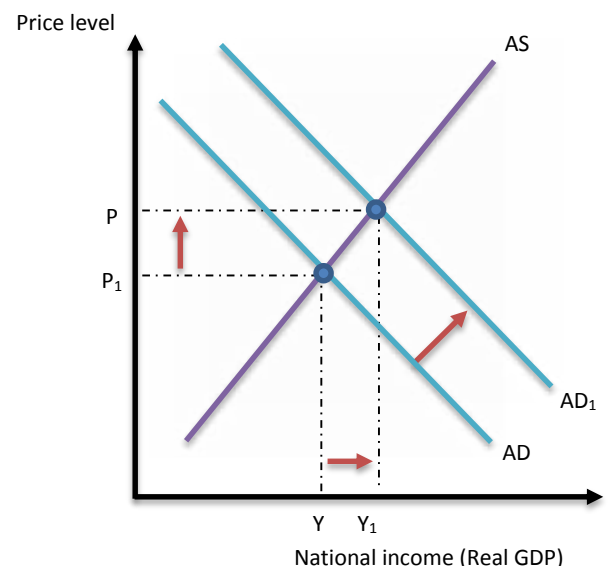
QUESTION 2:

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)

- The central bank can **decrease interest rates** (to make credit cheaper) and increase the money supply.
- This will increase consumer spending.
- These two activities by the Reserve Bank will increase demand for goods and services.

Fiscal policy (executed by the Minister of Finance)

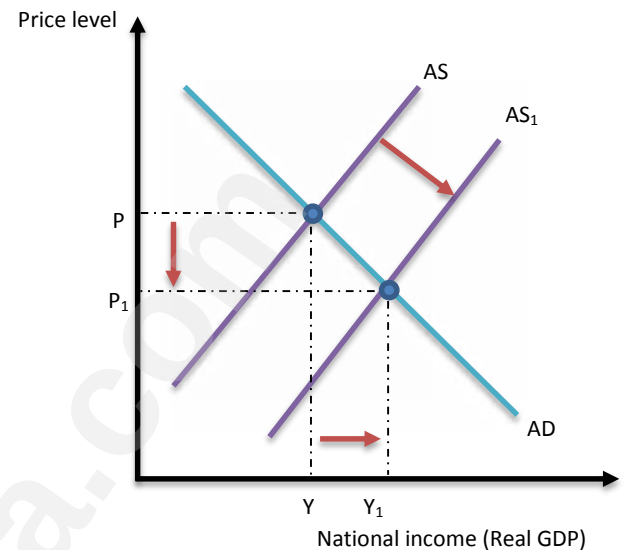
- The Minister of finance can **increase spending** (which leads to the multiplier effect) and **decrease taxes** (which increases disposable income).

- These two activities by the Ministry of finance will increase demand for goods and services.
- However, when aggregate demand exceeds aggregate supply or aggregate demand is increasing faster than aggregate supply, it will result to **demand pull inflation**.

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



QUESTION 3:

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

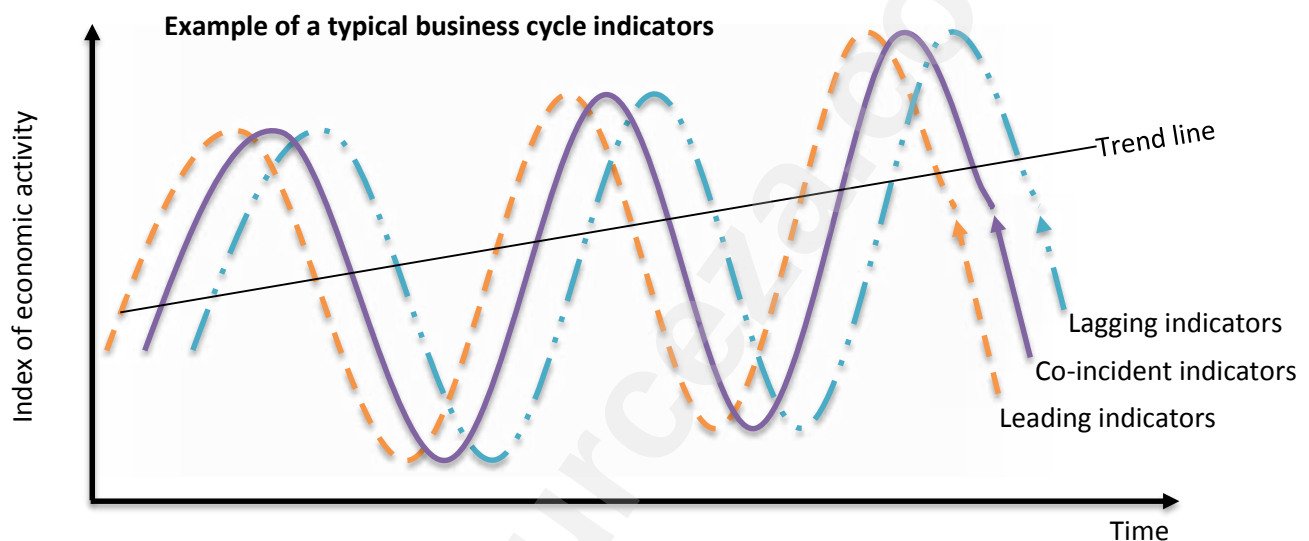
Coincident indicators

- 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 structure of the economy being measured



The length and amplitude of a business cycle

Length

- This is the time that it takes for a business cycle to move through **one complete cycle** (measured from peak to peak or trough to trough)
- If a business cycle has the length of 10 years it can be **predicted** that 10 years will pass between successive peaks or troughs in the economy.
- Longer cycles show strength.
- Cycles can overshoot.
- Ways to measure lengths:
 - Crisis to crisis
 - Historical records
 - Consensus on businesses experience

Amplitude

- It is the difference between the total output between a peak and a trough.
- It measures the distance of the oscillation of a variable from the trend line
- It is the **intensity** (height) of the upswing and downswing (contraction and expansion) in economic activity
- A large amplitude during an upswing indicates strong underlying forces – which result in longer cycles
- The larger the amplitude the more extreme the changes that may occur / extent of change
- E.g. During the upswing inflation may increase from 5% to 10%. (100% increase)

The trend-line of a business cycle

- It is a line showing the general direction that fluctuations seem to be heading.
- Economists look at the performance of the economy over the past few years and then predict a future trend.
- It usually has a positive slope because the production capacity of the economy increases over time
- Also known as the long term growth potential of the economy
- Trends are useful because they indicate the general direction in which the economy is moving – it indicates the rate of increase or decrease in the level of output

Tools used during forecasting

Extrapolation

- Forecasters use **past data** e.g. trends and by assuming that this trend will continue, they make **predictions about the future**
- Means to estimate something unknown from facts or information that are known
- E.g. if it becomes clear that the business cycle has passed through a trough and has entered a boom phase, forecasters might predict that the economy will grow in the months that follow
- It is also used to make economic predictions in other settings e.g. prediction of future share prices

Moving averages

- This is a method of **repeatedly calculating a series** of different **average values** along a time series to produce a smooth curve.
- Four main concepts of the average:
 - **Arithmetic:** e.g. $4 + 3 + 5 + 7 + 6 + 5 = 30 \div 6 = 5$
 - **Median:** e.g. $23 + 24 + \underline{25} + 26 + 27$ the median is 25
 - **Mode:** e.g. the number that occurs most often.
 - **Geometric:** is a type of mean or average, which indicates the central tendency or typical value of a set of numbers by using the product of their values

TOPIC:

PUBLIC SECTOR

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

MEMORANDUM:

QUESTION 4:

Problems of the provision of public goods and services

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

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

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

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

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 elasticities of demand for a good (e.g.) commercial and manufacturing businesses pay higher rates than households and they pay on a sliding scale

QUESTION 5:

State's macro-economic objectives

- **NOTE:** As a way of remembering the macro-economic objectives, I use the word **BEFEPE**.
Also take NOTE that the word (BEFEPE) can only be used by the candidate as a way of reminding him/her and **not** as an economic term that can be used to answer any question in the exam:
 - B: Maintain Balance of payment equilibrium
 - E: Economic growth
 - F: Full employment
 - E: Exchange rate stability
 - P: Price stability
 - E: Economic equity

Maintain balance of payments equilibrium

- The deficit on the trade balance shows a much bigger increase of imports compared to exports
- The South African Government aims to achieve a satisfactory balance of payments position, particularly in the trades in goods and services department in the current account section.
- Governments are not always concerned if there is a current account deficit because in the long run, it is likely to see an increase in international competitiveness which helps keep aggregate demand and output levels high.

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.

TOPIC:

INTERNATIONAL TRADE

[**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

MEMORANDUM:

QUESTION 6:

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.

Import substitution

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

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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
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)

MEMORANDUM:

QUESTION 7:

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
Output	Output is high and the consumer has a	Output is relatively high as many sellers	Output is low with little choice	Output is low with no choice or

	large variety to choose from	occupy the market		variety available to consumers
Non-price competition	None	Yes: through advertising and product differentiation	Yes: through advertising and product differentiation	None: No competition whatsoever
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

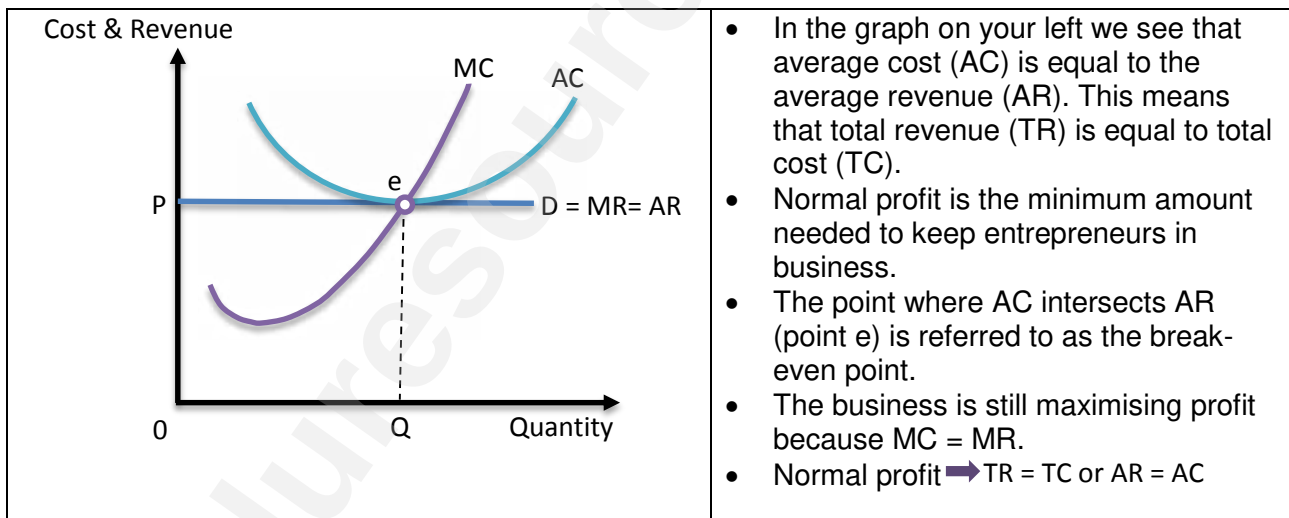
QUESTION 8:

Profits

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

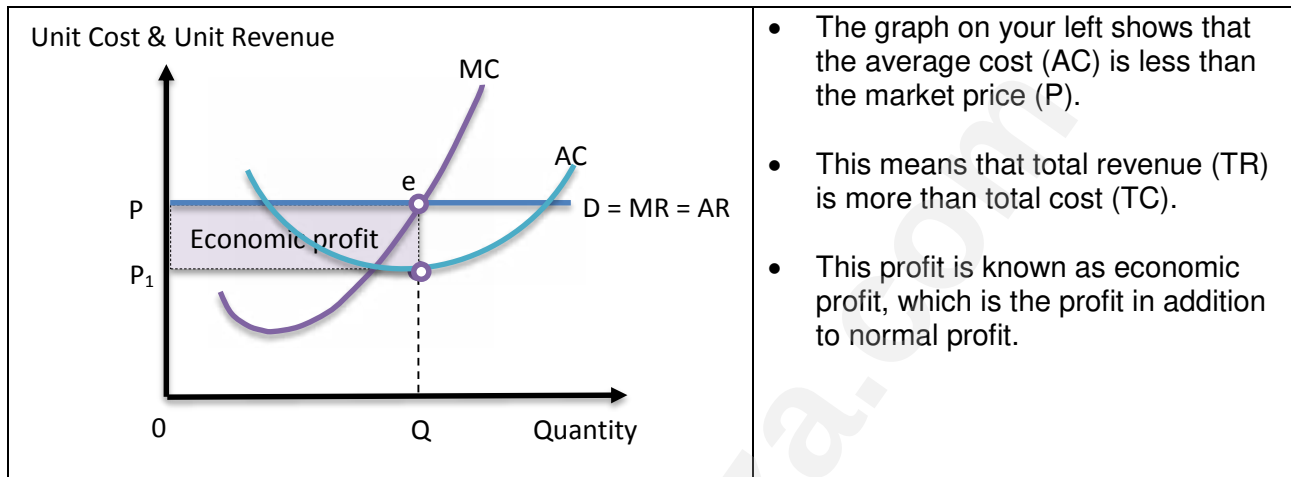
- When economic profit is equal to **zero**; this occurs when the difference between total revenue and total cost (explicit and implicit costs) equals zero.



- 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.

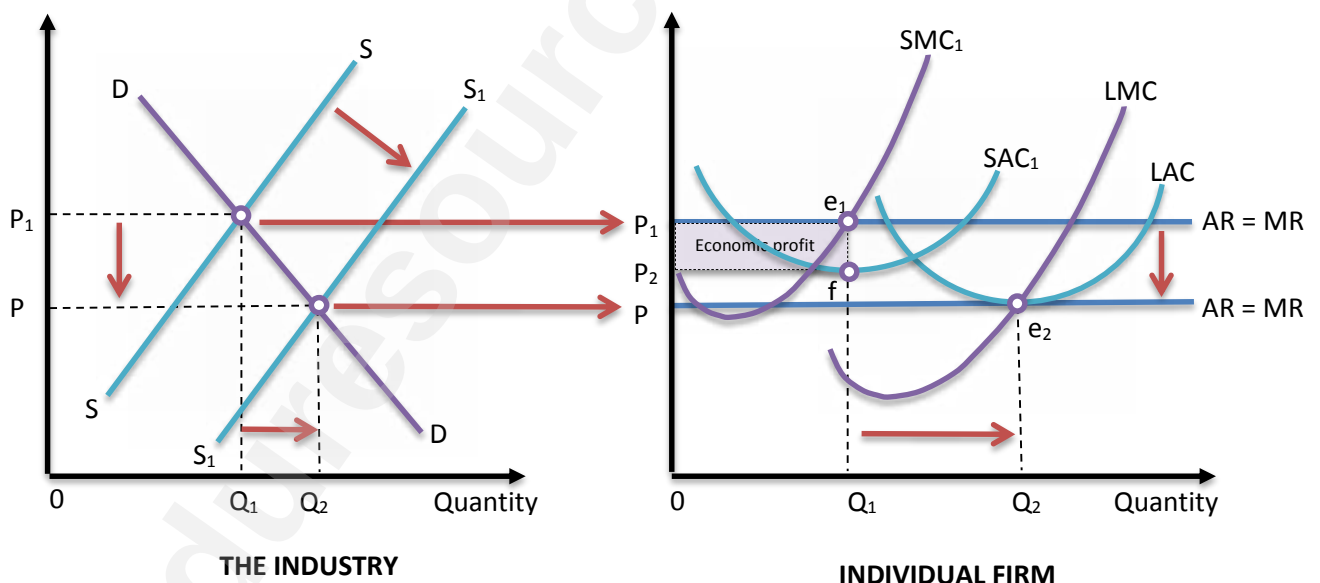
Economic profit

- 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 long-run equilibrium output level

- 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_1 the business is making an **economic profit** of $P_1 - e_1 - P_2$ (shaded area) with the short-term plant-size represented by SAC_1 .
- At a price of P_1 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

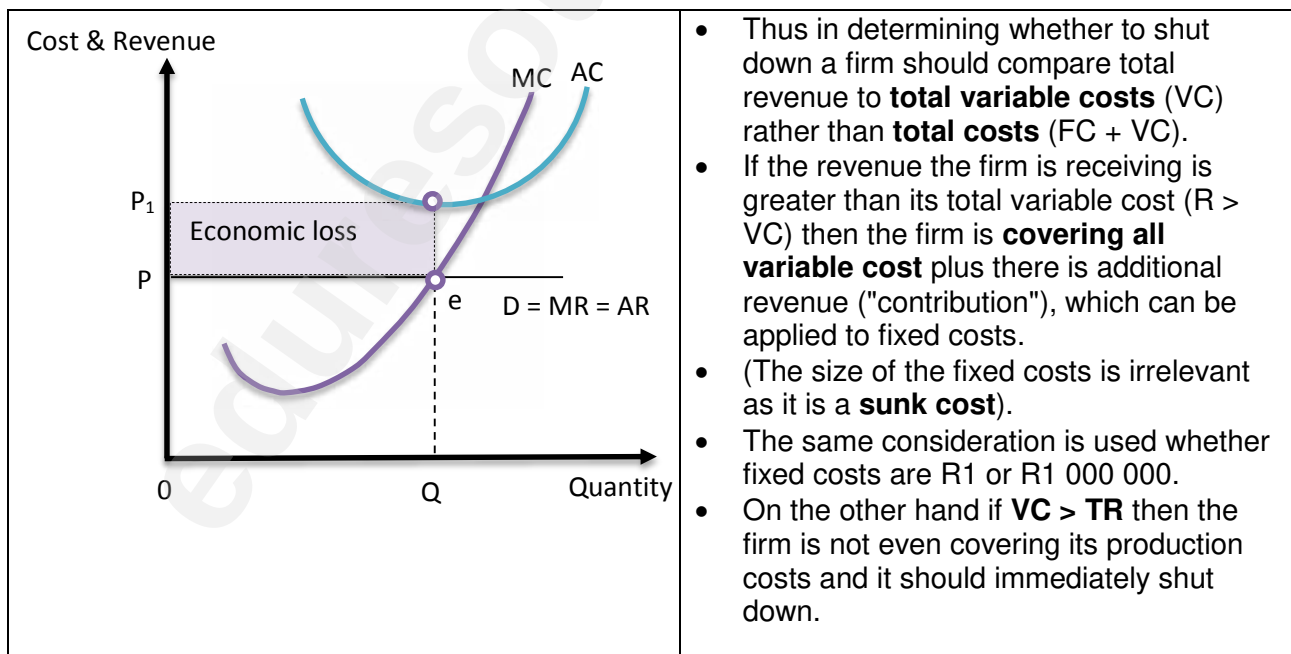
- Once long-term equilibrium has been achieved, and provided that there are no changes in the technology or the factors of production, there will be no further entry or exit of businesses
- The output is produced at the lowest possible cost (minimum point of LAC).
- The consumer pay the lowest possible 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

Unit 6: 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**.
- However, if the price is below AC per unit and TR is less than TC , then the firm makes an **economic loss**

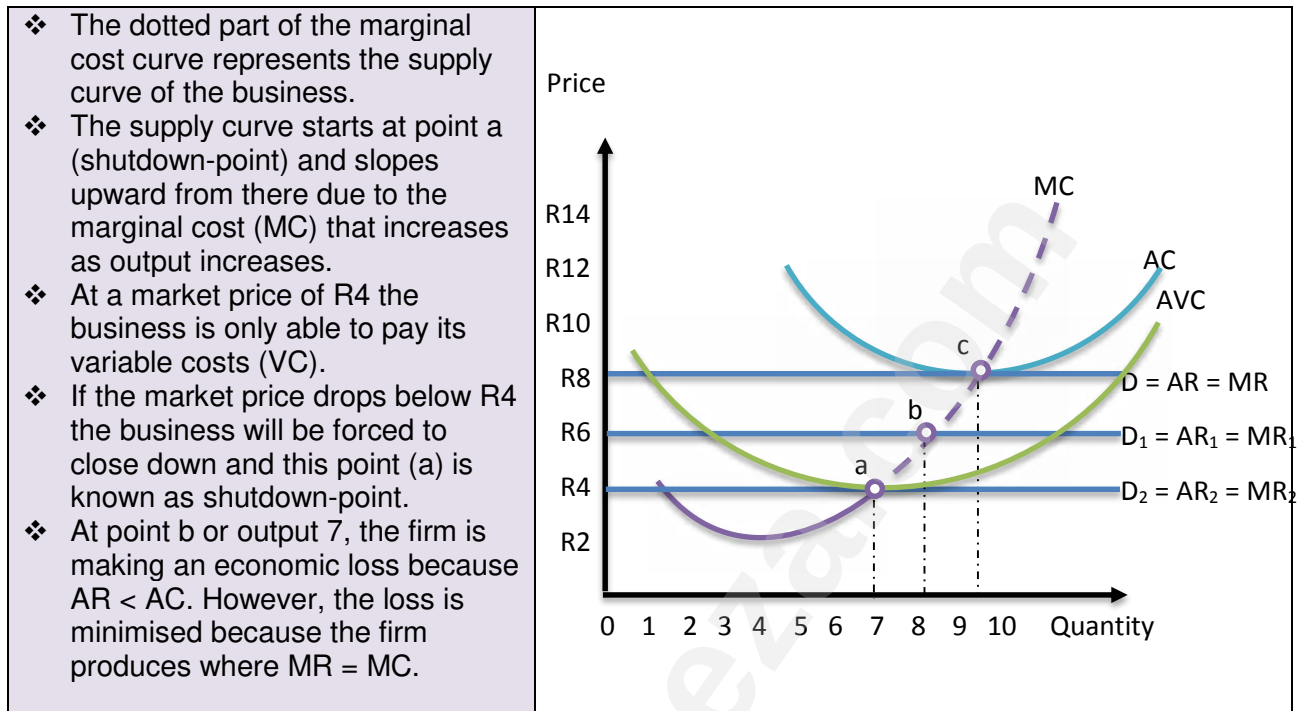
Economic loss

- In the **short run**, a firm operating at a loss [$TR < TC$ (total revenue less than total cost) or $P < ATC$ (price less than unit cost)] must decide whether to continue to operate or temporarily **shut-down**.
- The **shutdown rule** states "in the short run a firm should continue to operate if price exceeds average variable costs." Restated, the rule is that for a firm to continue producing in the short run it must earn sufficient revenue to cover its variable costs.
- The rationale for the rule is straightforward. By shutting down a firm **avoids all variable costs**.
- However, the firm **must still pay fixed costs**. Because fixed cost must be paid regardless of whether a firm operates they should not be considered in deciding whether to produce or shutdown.



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 variable cost (TVC) is greater than the total revenue (TR) being made ($TVC > TR$) then the firm is not even covering production costs and it should be shut-down immediately.

TOPIC:

DYNAMICS OF IMPERFECT MARKETS

9. Discuss the monopoly in detail
10. Examine the oligopoly in detail

MEMORANDUM:

QUESTION 9:

Monopolies

- The word monopoly is derived from the Greek words monos meaning **single** and polein meaning **sell**. 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.
- Consumers cannot purchase the product from any other producer but the monopolist.
- A further requirement is that entry to the market should be **completely blocked**.
- Although monopolies may be big businesses, size is not a characteristic of a monopoly.
- A small business may still have the power to raise prices in a small industry.
- Monopolies can be established by a government, form naturally, or form by integration.
- Holding a dominant position or a monopoly of a market is often not illegal in itself, however certain categories of behaviour can be considered abusive and therefore incur legal sanctions when business is dominant.

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

They may exploit consumers

- Because a monopolist is the only supplier of a product there is always the possibility of consumer exploitation.
- Government continually taking steps to guard against such practices.
- **Example:** the Competition Act 89 of 1998

Examples:

- Eskom, Transnet

Sources of Monopoly Power

- In a monopoly, specific sources generate the individual control of the market.
- Sources of power include:
 - Economies of scale
 - Capital requirements
 - Technological superiority
 - No substitute goods
 - Control of natural resources
 - Legal barriers
 - Deliberate actions

QUESTION 10:

Oligopolies

- The word oligopoly is derived from the Greek 'oligo' which means '**few**', and 'polein', which means '**sell**'.
- 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.
- With few sellers, each oligopolist is likely to be **aware** of the **actions of the others**.
- The decisions of one firm therefore **influence** and are **influenced** by the decisions of other firms.
- Strategic planning by oligopolists needs to take into account the likely responses of the other market participants.
- Oligopolistic competition can give rise to a wide range of different outcomes.
- In some situations, the firm may employ restrictive trade practises to raise prices and restrict production in much the same way as a monopoly.

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

eduresourceza.com

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
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

MEMORANDUM:

QUESTION 11:

Market failure:

- When free markets fail to produce the quantities of goods and services that people want at prices that reflect the marginal utility (value to the consumer) of the product best available or optimal production outcome has not been achieved / failure of markets to **achieve optimum resource allocation**

Reasons for market failure

NB: As a way to remember the 6 causes of market failure: **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.
- 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.
- Most businesses operate under conditions of imperfect competition that allows them to restrict output, e.g. monopoly, duopoly, oligopoly
- Raise prices and produce where price exceeds marginal cost.
- 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

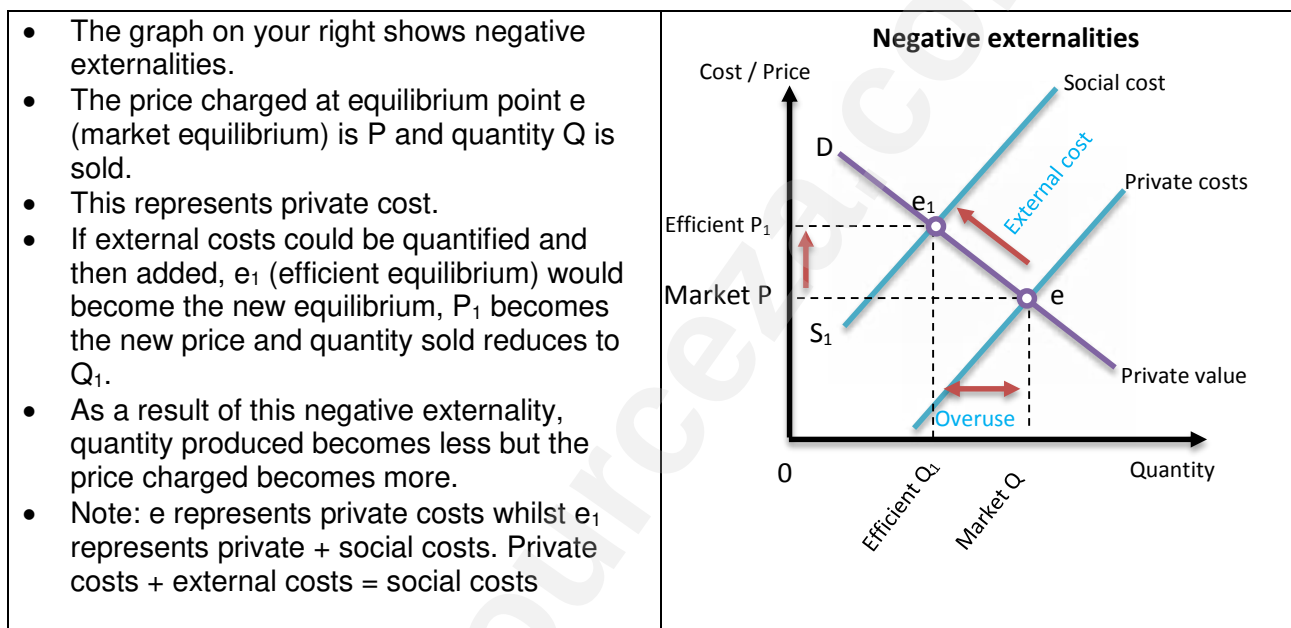
- **Labour**
 - **Geographic immobility of labour:** people are usually happy where they are, they have relatives and friends, they know the town and area, and they are members of various clubs and other social groupings.
 - **Institutional immobility of labour:** pension schemes may tie people into 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

QUESTION 12:

State intervention as a consequence of market failures

Direct control:

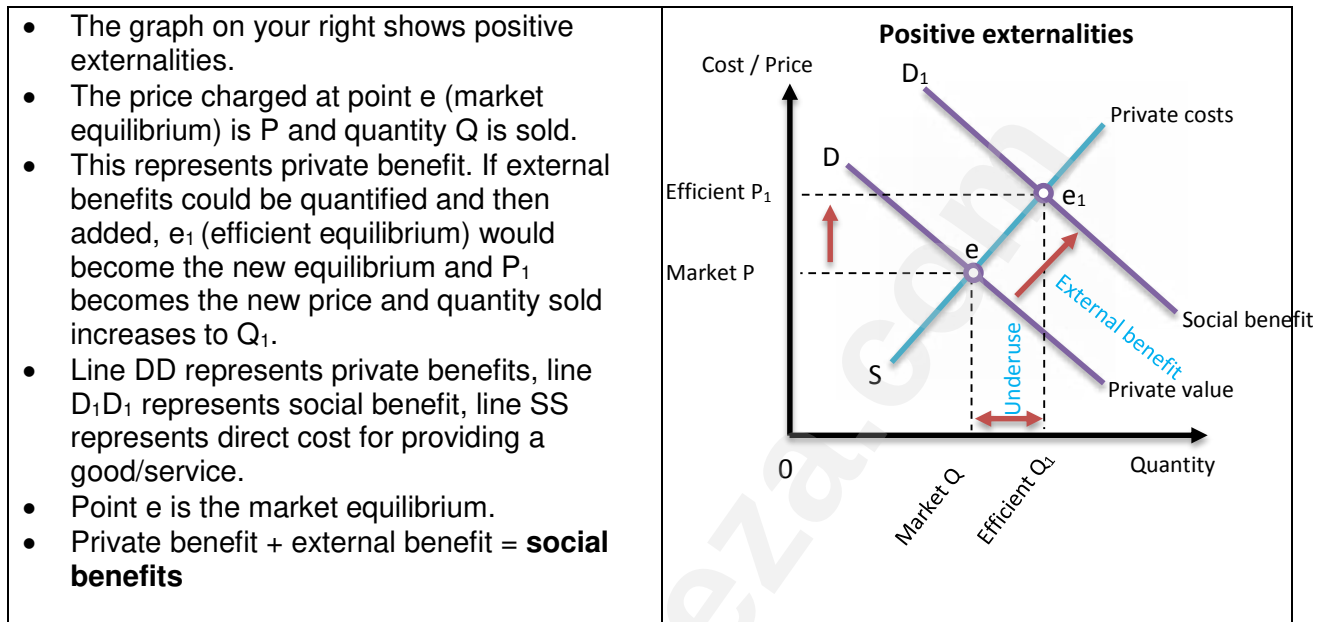
- The government can pass laws or use existing legislative framework to control businesses that generate negative externalities.
- **Positive externalities**
 - Government can grant a subsidy to encourage consumption of goods with a positive externality.
 - In a free market, there is under consumption of goods with positive externalities because people usually ignore the external benefits their decisions make



- 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 on goods that have an external cost, which will reduce consumption. A typical example is sin tax charged on cigarettes.

• 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.



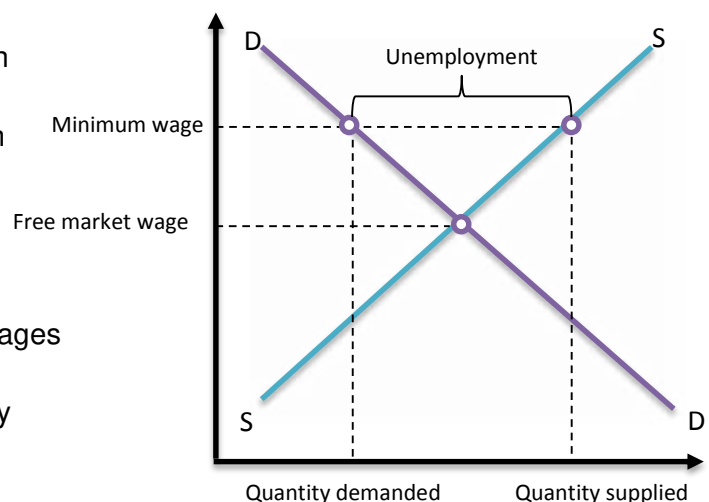
- In case of positive externalities, freely operating markets fail because they provide less than the required quantity of a socially useful product e.g. education.
- Solution would be paying a subsidy that is equal to the external benefit, which will increase consumption of merit goods.
- A typical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

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

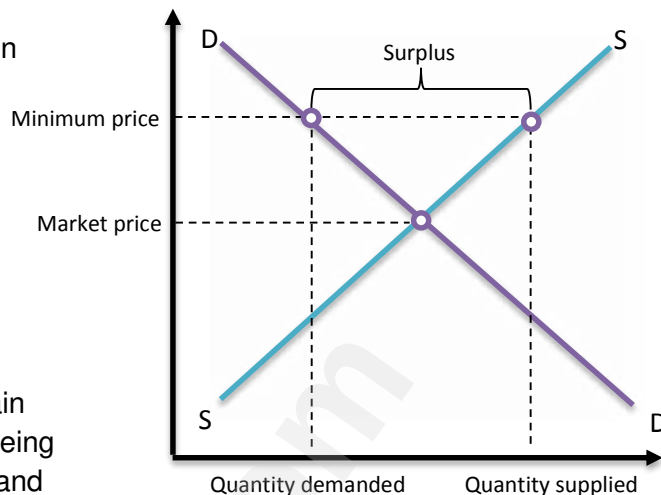
Minimum wages:

- 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.



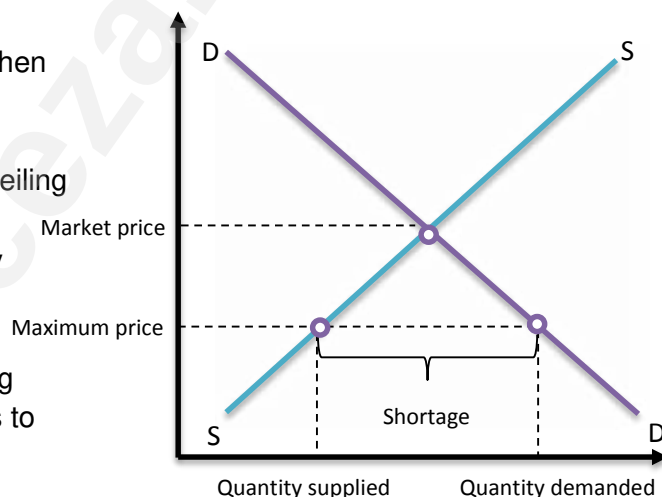
Minimum Prices:

- 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:

- Progressive tax system: charging high income earners more tax than low income earners
- Government can also 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.

Subsidies:

- The government provides subsidies to producers in order to encourage them to increase the production of goods.
- Supply increases.
- 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.

Redistribution of wealth:

- The South African government uses taxing 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 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)]*

14. 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)]*

MEMORANDUM:

QUESTION 13:

The demand-side approach to growth and development

Demand factors

- The term demand-side approach to growth and development is a policy that focuses on the **aggregate demand** created by households, businesses, the government, and the foreign sector, and how to use this demand as an important driving force in growing the economy.
- It focuses on **expanding** the **aggregate demand** for goods and services produced in the economy.
- There should be adequate and growing demand for goods and services produced in the economy.

Demand-side policies to stimulate growth

- Involves discretionary methods to influence aggregate demand and output through changes in the monetary and fiscal policies

Monetary policy

- consists of decisions by **central banks** (SARB) to influence the **rate of interest** and the **supply of money** in the economy
- Central banks manage the availability of money by means of open market transactions and cash reserve requirements
- To carry out open market transactions, the central bank buys and sells government securities (bonds) in the banking system.
- A change in the cash reserve requirement makes more or less money available in the banking system. The cash reserve ratio in South Africa is currently 5%
- They manage the cost of money by means of interest rate changes. This is done through moral persuasion
- The SARB consults with the commercial banks and they follow the lead of the central bank. The commercial banks follow the changes in interest rates announced by the central bank by immediately changing their rates

Fiscal policy

- focuses on **budget deficits** and **surpluses** to either raise or reduce aggregate demand
- By varying taxes and expenditure government can either stimulate or inhibit economic growth and development
- A mixture of monetary and fiscal policies is used to **fine-tune** the economy
- Fiscal policy improve growth by providing finance for the following
 - **Training:** lack of skills hampers growth and reduces chances for employment. Therefore funding skills development helps stimulate growth
 - **Infrastructure:** infrastructure development helps improve logistics, which is key for an economy.
 - **Increasing foreign trade:** export promotion needs funding through subsidies, incentives and trade neutralities which improves exports which leads to growth
 - **New businesses:** financial support is needed to encourage new businesses which leads to growth
- Fiscal policy improve development in the following ways:
 - **Progressive tax system:** helps reduce income inequality
 - **Welfare grants:** they reduce poverty
 - **Reducing taxes:** helps increase disposable income
 - **Land ownership:** helps create fairness in land distribution and improves development
 - **Home ownership:** housing subsidy schemes improve development since it increases home ownership
 - **Benefits in kind:** free goods and services improves standards of living
- **To ensure economic growth**, there should be an adequate and growing demand for goods and services
 - **Total demand consist of:** Consumption demand (C) / spending, Investment demand (I) / spending, Government demand (G) / spending, Exports minus imports (X-M).
 - Thus: $\Delta GDP = \Delta C + \Delta I + \Delta G + \Delta(X-M)$
 - An increase in exports raises the growth rate.
 - Also has the advantage of contributing to the equilibrium in the balance of payments account
 - Economic growth can be stimulated to reduce the import of certain products by producing these products domestically.
- **Factors that influence development strategies:**
 - Emphasis is placed on the human aspects of development which include satisfying basic human needs and the importance of self-esteem and freedom of choice
 - A key element of economic development is that the people of a country must be major participants in the process that brings about improvement in the lives of the population

QUESTION 14:

The supply-side approach to growth and development

Supply factors

- 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.

Supply-side policies to stimulate growth

- 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:
 - Human Resources (labour),
 - Natural Resources,
 - Capital Formation,
 - Entrepreneurship and
 - Technology

South African approach to supply-side policy

- There are various factors that promote the efficiency and effectiveness of resources. South Africa has implemented many of these elements in partnership with the supply-side approach.

Education and training

- The fastest growing part of South Africa's economy falls beyond the primary sector.
- This means that the demand for skilled labour is increasing at a steady pace.
- The Sectoral Education and Training Authorities (SETAs) have been created to promote and facilitate work-related training for the different sectors in the economy.

Small, medium and micro-enterprise

- The South African government encourages the establishment of SMMEs through various financing and support structures.
- Funding sources such as Khula, the National Empowerment Fund, the Industrial Development Corporation and Business Partners are in partnership with national government.
- There are also free advisory centres available to provide information on topics such as managing and running SMMEs.

Fiscal policy

- High tax rates can discourage individuals, leading them to work less and businesses to invest less.
- South African tax rates have been reduced over the past few years and tax incentives are given to industries operating in areas prioritised by government policies.

Competition

- 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.

Deregulation

- The deregulation of regulated industries provides for greater competition in the market.
- Many unnecessary laws and other barriers to competition in South Africa have been removed, although there are still some regulations, especially those concerning the informal sector that has to be revised.

Labour legislation

- Labour legislation includes the Labour Relations Act, the Employment Equity Act and the Basic Conditions of Employment Act.
- The new labour legislation provides for a fair and equitable working atmosphere.
- Such a workplace will motivate workers to not only improve the quality of their work but also strive towards self-development.

Research and development

- A research and development (R&D) strategy has been implemented by government to improve national competitiveness and an improved quality of life for South Africans

Privatisation

- Privatisation is essential for the promotion of competition in the market place, as it gives private institutions the opportunity to participate in the supply of strategic services.

Infrastructure

- A well-developed infrastructure is the backbone of a growing economy. South Africa has one of the better-developed infrastructures in Southern Africa such as transport, energy and telecommunications.

TOPIC:

INDUSTRIAL DEVELOPMENT POLICIES

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

MEMORANDUM:

QUESTION 15:

Regional development in South Africa

- An estimated 80% of the country's GDP is produced in four industrialised areas, namely:
 - Johannesburg-Pretoria-Tshwane
 - Durban-Pinetown
 - Cape Town metropole
 - Port Elizabeth-Coega-Uitenhage
- Reasons for the uneven geographical economic development
 - Unequal spending on regional development
 - Uneven distribution of economic resources, such as natural resources and skilled workforce
- The regional development policy aims to promote a more even spread of industries so that capital and labour can be directed towards under-developed areas.
- Regional development is currently based on the Spatial Development Initiatives (SDIs), Special Economic Zones (including IDZs and corridors)

South Africa's endeavours

Spatial Development Initiatives (SDIs)

- SDI is a policy to promote sustainable industrial development in areas where poverty and unemployment are at their highest.
- It can be defined as a link between important economic hubs and regions in a country.
- The main objective is to stimulate economic growth and employment in those regions.

These are the main SDIs and their economic focus:

- KwaZulu-Natal SDI Industrial
- Wild Coast SDI Agri-tourism
- Fish River SDI Industrial
- West Coast Investment Initiative Industrials and agri-processing
- Coast to coast Corridor Transport and Tourism
- Platinum SDI Mining and agri-tourism
- Phalaborwa SDI Industrial and agri-tourism
- Gauteng Special Economic Zone Information technology, telecommunications
- Maputo Development Corridor Industrial and agri-processing
- Lubombo SDI Agri-tourism
- Richards Bay Initiative Mining, industrial and agri-processing

Financial incentives for SDIs:

- Duty-free incentives – duty-free import of raw materials or intermediate goods.
- Small and Medium Enterprise Development Programme (support operations).
- Skills support programme – tax-free grants for skills development.
- Critical infrastructure programme – cash grant to build or expand physical infrastructure.
- Foreign investment grants – cash grant to foreign companies that want to invest in new manufacturing businesses.

Industrial Development Zones (IDZ)

- A purpose built industrial estate linked to an airport or seaport with export as the main objective (it will be incorporated into the SEZ in future).

These are the current IDZs in SA:

- Coega – Steel and auto components
- OR Tambo International Airport – high tech industries
- East London – vehicles
- Richards Bay – metals
- Saldanha Bay – steel

Special Economic Zones (SEZ)

- Geographically demarcated area where specific economic activities have been identified to be developed.
- These areas may enjoy incentives such as tax relief and support systems to promote industrial development.
- It creates a basis for a broader range of industrial parks and provides economic infrastructure to enable the effective clustering of value-adding and employment-enhancing manufacturers.

Corridors

- A corridor is a track of land that forms a passageway allowing access from one area to another and is developed as part of regional development (also forms part of an SDI).

Strategic Integrated Projects (SIPs)

- Integration of economic and social infrastructure projects in the country.
- There are currently 17 designated projects identified.
- The Strategic Integrated Projects main objective is to identify and implement projects to achieve the provisioning of infrastructure.

Infrastructure plan

- The focus is on assessing infrastructure gaps and needs in terms of population growth.
- The main focus is on water, electricity, roads, sanitation and communication.

Incentives to encourage industrial development

- **Small Business Support Program**
 - This programme is designed for small businesses with assets of R100 million or less.
 - This incentive consists of a tax free cash grant for investment in industries.
 - Grants were available to new and expanding businesses.
 - Grants are given for three years after which the company is expected to become self-sustaining.
- **Seda Technology Program (STP)**
 - STP was created as part of government's national strategy of consolidating and rationalising small enterprise support interventions across the different government

departments and government agencies, within the overall objective of improving the delivery of small business support services to entrepreneurs and small enterprises.

- **Skills Development Programme (SSP)**
 - This a cash incentive to encourage greater investment in skills training and to introduce new, advanced skills to the SA labour force.
 - A maximum of 50% of a company's trading costs are covered.
- **Critical Infrastructure Programme (CIP)**
 - It is a cost sharing grant for projects designed to improve infrastructure in SA.
 - It covers a qualifying development cost between 10% and 30% towards the total development cost.
 - It becomes available on completion of the project.
 - It extends to both the public sector (e.g. municipalities) and private sector (companies).
 - It is deemed "critical" if the investment had not taken place or would not work optimally without the infrastructure.
- **Custom free incentives**
 - These incentives are aimed at export orientated manufacturing businesses that operate in the IDZs and SEZs.
 - Duty-free imports on intermediate products that will be used in the IDZ to produce other final goods.
- **Foreign investment incentives**
 - It is a cash incentive to assist foreign investors who want to invest in new manufacturing businesses in SA.
 - It covers the cost of relocating new machinery and equipment from abroad.
 - It becomes available to any registered company who would like to operate in the manufacturing sector.
 - It also covers up to 15% of the costs of new machinery and equipment to a certain value.
 - Strategic Investment Programme.
- **Services to business processes**
 - The BPS aims to attract investment and create employment in South Africa through off-shore activities.
 - A base incentive as a tax exempt grant is paid over three years for each offshore job created and maintained.
 - A graduated bonus incentive is paid as follows: – 20% bonus for more than 4 000 but less than 8 000 offshore jobs paid once off in a year in which the bonus is reached; – 30% bonus for more than 8 000 offshore jobs paid once off in the year in which the bonus level is reached.

QUESTION 16:

International best practice for regional development

These are the best international practices for regional industrial development policies:

Good governance

- Regional development strategies should be managed effectively and free of corruption. Democratic decision- making, transparency, financial management and control.
- Integration
- An integrated approach, ensuring that the benefits of one region spill over to other industries and areas.

Partnerships

- Partnerships should be built between central government, local authorities, civil society, special interest groups, NGOs and the private sector.

Provision of resources

- Sufficient resources should be provided in resource-poor areas, e.g. infrastructure, human resources.

Competitiveness

- Industries or business established as a result of regional policies should be competitive and not need ongoing financial aid from government.

Development of people, for people, by people

- Regional development concerns people, and aims to serve the people of the region. Training, education, improving productivity and providing essential goods and services to raise the standards of living in regions. People should be involved.

Development from below

- Concentrate on issues at grass roots level where most urgent human needs exist. It starts by dealing with poverty.

Total development as a multi-dimensional process

- Treat development from a global perspective covering all human life, including the interaction of special forces in a community, e.g. education, health, nutrition.

Free-market orientation

- Government intervention in markets should be kept to a minimum so that the forces of supply and demand and profit motives can allow for efficient allocation of resource

Sustainability

- The capacity of a region has 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

Investment of social capital

Governments need to improve the quality of education and healthcare in a region.

TOPIC:

ECONOMIC 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*]

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*]

MEMORANDUM:

QUESTION 17:

There are 6 key economic indicators:

As a way to remember: People pay money for every purchase.

- **P**eople: Production indicators
- **P**ay: Price change indicators
- **M**oney: Monetary change indicators
- **F**or: Foreign trade indicators
- **E**very: Employment indicators
- **P**urchase: Productivity indicators

Production Indicators

Real GDP

- This measures the growth performance of a country. It uses a price deflator so as to remove the effect of inflation
- Real GDP represents a Procyclical indicators
- **SA's GDP 2011:** (USD 403.9 billion), **2012:** (USD 382.3 billion), **2013:** (USD 350.6 billion)
- **USA's GDP 2011:** (USD 15,52 trillion), **2012:** (USD: 16,16 trillion), **2013:** (USD: 16,77 trillion)

GPD @ current prices

- Uses nominal prices i.e. effects of inflation are not catered for

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 $\pm 75\%$ 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

QUESTION 18:

Social indicators

- Social indicators are statistics that measure the level of social development and human welfare within a country. There are 6 Social Indicators:

Social Indicator	As a way to remember:
1. Demographic indicators	D
2. Income indicators	I
3. Education indicators	E
4. Housing indicators	H
5. Urbanisation indicators	U
6. Nutrition indicators	N

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.
- **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
20. Discuss in detail the causes of cost-push inflation
Wages - Key inputs - Exchange rate depreciation - Profit margins - Productivity - Natural disasters

MEMORANDUM:

QUESTION 19:

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.

QUESTION 20:

Causes of cost-push / cost inflation

- ❖ **Wages:** as remuneration for labour increases, the cost of production increases, thereby pushing prices up
- ❖ **Cost of key imported inputs** (e.g. oil, machinery etc.): When prices of imported goods increase, domestic cost of production also increases
- ❖ **Exchange rate depreciation:** Imported goods become more expensive
- ❖ **Increase in profit margins:** When profit margins are pushed up, cost of production increases – recover higher profits by increasing prices.
- ❖ **Decrease in productivity:** If factors of production become less productive and receive the same remuneration (*ceteris paribus*), cost of producing each unit increases
- ❖ **Natural disasters:** e.g. droughts and floods have a negative effect on cost of producers
- ❖ Causes **vicious circle:** higher wages, higher prices, higher cost of living
- ❖ **Strikes and stay away** reduce production output: supply drops and the prices rise
- ❖ **Direct and indirect taxation increased:** producers and employees adjust incomes and products become more expensive (shifting taxes)
- ❖ **Administered goods' prices** increase (controlled by state) trade unions negotiate higher wages and producers add increase to price of final product e.g. petrol, postage, electricity, water
- ❖ **Shoplifting and losses** caused by employees of business estimated beforehand and added to prices of all products
- ❖ **High prices of agricultural goods:** due to high cost of inputs e.g. diesel and fertilizers – higher food prices
- ❖ **High interest rates** justified to encourage savings: is cost item for businesses – included in prices
- ❖ **Supply shocks:** such as a sudden increase in the price of oil.
- ❖ **An increase in factor prices,** such as the cost of labour or land

TOPIC:

TOURISM

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

MEMORANDUM:

QUESTION 21:

Effects of tourism

Positive Effects of Tourism:

GDP

- Biggest impact on services industry than on agriculture or manufacturing
- Indirect contribution: 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:

- 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

Poverty

- Tourism is fast + effective distribution mechanism in development of rural areas
- Prime tourism attractions located in rural areas
- Promote balanced + 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

- Adequate physical, economic + 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, reuse removal, sewerage systems).
- Lack of economic + basic services infrastructure prevents growth of tourism
- This infrastructure is seen as public investment
- Seasonality – major problem for infrastructural development

Externalities

- Has positive and negative impacts:
- 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.

Negative Effects of Tourism:

Externalities

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

Environment

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

Infrastructure

- Seasonality – major problem for infrastructural development

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 diseases
- concentration of funds at tourist sites and to uplift social infrastructure at the expense of developing other areas

QUESTION 22:

Benefits of tourism,

The following sectors benefit the most from tourism:

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

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

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.

Infrastructure

- 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.

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
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

MEMORANDUM:

QUESTION 23:

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.

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.

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.

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

Command and Control (CAC):

- The government enforces policy by setting maximum levels of the emission of pollution.
- Most developed countries have regulations that control air and water pollution.

Voluntary agreements:

- The government concludes agreements with businesses on a voluntary basis to cut pollution.

Education:

- Education is used to try to change people's attitudes towards the environment.
- Innovative approaches have been tried in the developing world to educate people, e.g. setting up community wildlife reserves.

QUESTION 24:

International measures taken to ensure sustainable development

- Environmental problems are global problems.
- For example, pollution from motor vehicles and the greenhouse effect have an impact on the entire world.
- Polluted air and water moves from one country to another, and if the ocean is polluted in America, it can affect beaches in Australia.
- International measures have been implemented to deal with the following 5 environmental problems:

Biodiversity loss:

- If species become extinct (die out completely), this cannot be reversed.
- Modern techniques such as gene transplants can limit the loss of species.
- The Convention on International Trade in Endangered Species (CITES) sets many policies to deal with species loss.

Chemical waste:

- Chemical waste is toxic (it has a negative effect on living beings and can cause infertility or death).
- Chemical waste needs to be carefully managed to ensure it does not seep into the ground water.
- The Stockholm Protocol is a United Nations agreement to limit chemical waste.

Hazardous waste:

- Hazardous waste is highly toxic. It has a slow decomposition rate (it stays poisonous for a very long time).
- The most hazardous (dangerous) waste is radioactive waste from nuclear power.
- The Basel Convention is an international agreement to manage nuclear waste. South Africa is a signatory to the agreement.

Climate change:

- Global warming primarily causes climate change.
- Climate change can be reversed through widespread international co-operation, e.g. sharing weather information and weather patterns; agreeing to limit pollution; and banning chemical products such as greenhouse gases that damage the ozone layer.
- The Kyoto Protocol of 1997 is an international agreement to limit the production of greenhouse gases, because voluntary reductions of carbon dioxide levels did not succeed.

Loss of indigenous knowledge:

- Indigenous people have a lot of knowledge about the natural environment, which they use to make a living.
- Indigenous people traditionally used organic methods and natural processes.
- As indigenous people lose their habitats or are urbanised, this knowledge is disappearing and is being lost to the world forever.
- Local capacity-building is very important for the environmental sustainability of indigenous people, i.e. finding a way for them to earn a living in their traditional environment.

Major international agreements

- Since the 1990's the United Nations has convened various meetings with all countries worldwide on issues affecting them.
- They should take responsibility for the management of these issues.
- **Rio de Janeiro summit (UNCED):**
 - This summit took place in 1992 with the objective of sustainable development.
 - Envisaged outcomes included: environmental protection as an integral part of development, cooperation to conserve, protect and restore the health of the ecosystem, prevent environmental degradation where the polluter should bear the cost of pollution and assess the environmental impact.
- **Johannesburg summit (WSSD):**
 - Hosted in 2002 in Johannesburg on Sustainable Development.
 - Envisaged outcome of the programme includes: poverty eradication, changing unsustainable patterns of consumption, globalisation, health and the environment.
- **Rio +20 summit:**
 - Also known as the United Nations Conference on Sustainable Development took place in Brazil. The main issue was sustainable growth and poverty eradication without damaging the environment. It was agreed that a green economy would be one of the tools for sustainable development. Sustainable development goals covering economic, social and environmental aspects will replace the MDG from 2013.
- **Kyoto-protocol:**
 - This conference held in 1997 in Kyoto, established legally binding obligations whereby industrialised countries agreed to reduce their emission of six greenhouse gases.

- **Millennium Development Goals:**
 - Communities depend on healthy ecosystems to survive and prosper.
 - Some of the MDGs are: eradication of extreme poverty and hunger, achieve universal primary education, gender equality, reducing child mortality rates, improve maternal health, combat HIV/Aids and other diseases and create a global partnership for development.
- **United Nations Framework Convention on Climate Change (COP 17):**
 - The 17th Conference of the Parties was held in Durban where the following decisions were taken:
 - Commitment to the Kyoto Protocol and reducing pollution by greenhouse gases.
 - A Green Climate Fund to help developing countries to establish cleaner sources of energy and to adapt to climate change.
 - An Adaptation committee of 16 members to report to COP 18 on the improvement of the ability of the poorest and most vulnerable countries to adapt to climate change, better protection and help against losses and damage related to climate change