



education

Department:
Education
PROVINCE OF KWAZULU-NATAL

CURRICULUM GRADE 10 -12 DIRECTORATE

NCS (CAPS) SUPPORT DOCUMENT

GRADE 12



ECONOMICS

LEARNER REVISION DOCUMENT

2020

How to use this booklet

This booklet is developed to assist the Grade 12 Economics learners with the revision in the following topics:

- Macro - Economics
- Micro – Economics
- Economic Pursuits
- Contemporary Economic Issues

It should be used in conjunction with other prescribed textbooks and sources where detailed information is provided before answering the questions provided. You should understand the action verbs in order to know how to respond appropriately to the question. For example; mention, comment, and evaluate. Refer to 2017 Grade 12 Economics Examination Guidelines for the explanation of the action verbs. It is important to study all topics in the Economics curriculum to pass the subject because all topics are assessed and carry the same weight in the examination. Ensure you understand all the relevant concepts, formulae etc.in all topics of the subject.

Use various activities provided to revise each topic you have completed. These activities will guide you on what and how to approach questions in each topic. Covering all these activities will empower you for the examination.

When you are confident that you understand the topic attempt the questions set in the Assessment Section of each topic explained. Find other past question papers from November 2014 to June 2020 and go through similar questions. Your Economics teacher will always be available to offer assistance.



Economics consists of two examination question Papers with the following sections:

Section A is compulsory. There is multiple choice, Matching of terms and description of concepts. This is where you will get more easy marks.

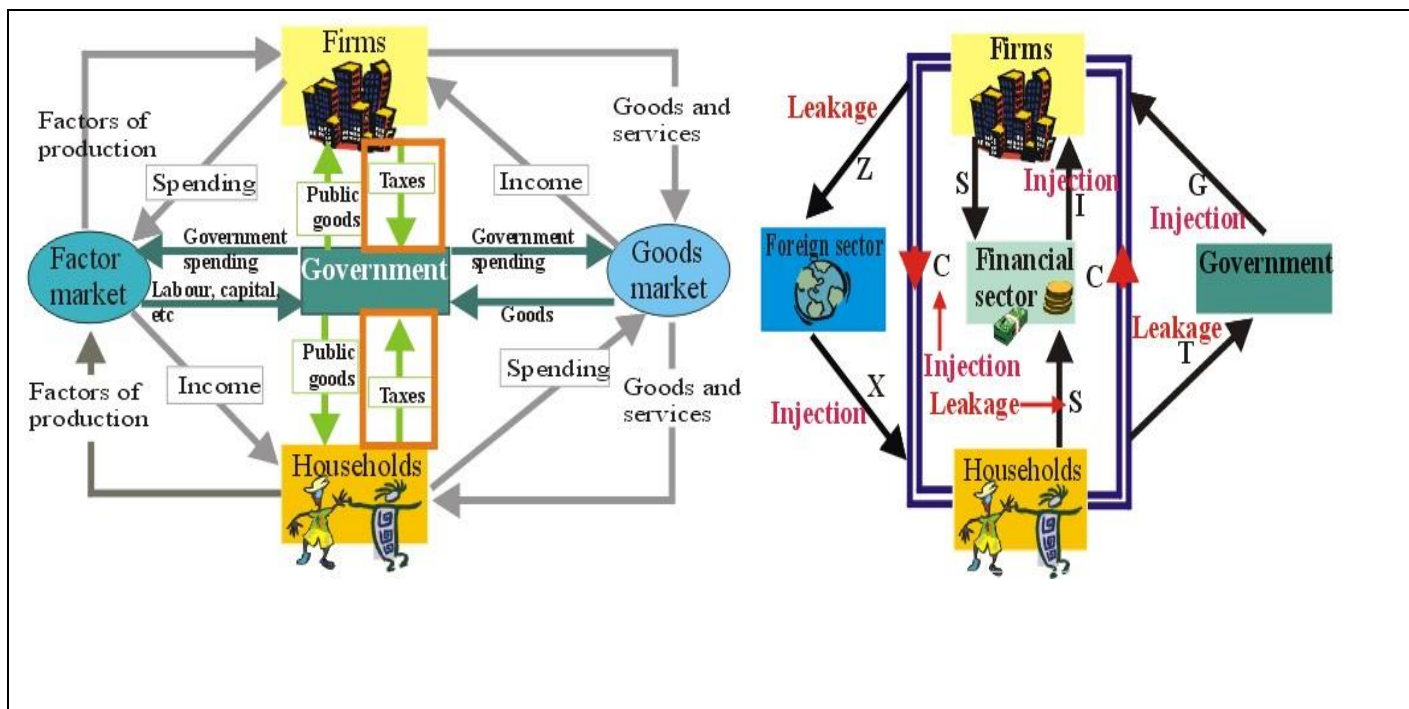
Section B has questions ranging from lower to middle and higher order. The marks range from 1 mark to 8 marks. For this section it is important to understand the current issues in Economics. There are a number of easy marks that you can earn. Start with lower order questions and work your way to middle order and finally to higher order level. Each activity is developed starting with lower order and moving to middle and higher order levels. This is how your examination paper will look always look like.

Section A and B is the 40% where you will earn easy marks, start by understanding questions asked in these two sections.

Section C: These are essay type of questions. Study the topics thoroughly to be able to earn marks on naming and discussing concepts. This is where you will earn the extra 20% of easy marks. **All essay topics for both Economics Paper 1 and 2** are listed in the 2017 Grade 12 Economics Examination Guidelines.

TOPIC: CIRCULAR FLOW

KEY CONCEPTS



The above **circular flow model** shows how the household sector, the public sector, the business sector as well as the foreign sector interacts with one another in an open economy. They are all economic participants. We also observe the three (3) markets in the model i.e. the factor market, the goods / services market and the financial market.

Key Concepts

Open economy: An economy that imports and exports goods and services to other countries.

Closed economy: An economy that does not take part in international trade.

Circular flow model - The flow of production factors (real flow) and goods / services (also the real flow) AND the flow of money (e.g. wages, profits, disposable income of consumers will be the money flow) between households, firms and the government in the economy.

Economic goods and services = these goods / services are scarce have utility and value which contributes to the wealth of citizens of a country e.g. money and property;

Participant ① Consumers (C) = Household sector - Individuals which buy and consume goods and services, owns and control the factors of production by selling or renting them;

Income (Y) – remuneration for the use of the factors of production in the form of rent, wages, interest and profits;

Disposable income – Income earned after the deduction of taxes;

Consumer expenditure - the spending of consumers on final goods and services;

Savings – Income that is not consumed;

Participant ② Enterprise = Firms = Business sector – Economic units that demand productive resources from households and supply goods and services to households and the government;

Investment (I) – Spending by firms on capital goods;

Participant ③ Government (G) = State = Public sector – all aspects of local, regional and national government which include public corporations such as Denel, Telkom, Transnet, Eskom, SARB and the SABC;

Transfer payment – payment by government to transfer spending power from one group to another, such as pensioners, disabled people and children; A transfer is 'no remuneration' for the use of factors of production as the people who receive the transfer are not employed;

Investment – money spent on capital goods by firms or a business: Output = Quantity total produced;

Subsidy – payment by government to producers to increase income and lower market prices of products; it bridges the gap between factor cost and market prices

OR

Subsidies on production – subsidies that are not linked to specific goods or services, e.g. subsidy on employment;

Subsidies on products – financial incentives to help struggling industries to produce, as well as direct subsidies payable per unit exported to encourage exports (e.g. government subsidy on bread);

Taxes (T) – Compulsory payments made by private individuals or business enterprises to the government sector with no direct benefit;

Taxes on production – refer to taxes on production not linked to a specific good or service (e.g. tax on land and buildings);

Taxes on products – taxes that are payable per unit of some good or services (e.g. VAT, import duties & sin tax);

Participant ④ Foreign sector – all economic activities carried out beyond the border of a nation;

Foreign trade – the exchange of goods between countries in the form of imports and exports;

Imports (M or Z) – goods produced by the foreign sector and purchased by the household, business or government sectors in the domestic economy;

Exports (X) – goods produced by the domestic economy and purchased by the foreign sector.

Foreign investment takes place when a foreign firm buys a business in our country, then this would be an **inflow of foreign investment** into our economy.

When a foreign firm sells their assets, owned in our country, it is called an **outflow of foreign investment**.

Market ① Financial sector or market – this sector represents those financial institutions (e.g. banks, pension funds, JSE, insurance companies) who are not directly involved in the production of goods and services but act as a link between households and firms;

Market ② Goods / Service market – a market where goods and services are traded;

Market ③ Factor market – represents the amount received by the various factors of production;

We distinguish between two types of flows in the economy circular flow model.

Monetary (money) flows - the flow of income and expenditure between the participants in the circular flow;

Real flows - the flow of production factors and goods / services between participants in the circular flow.

On the model we also observed leakages and injections.

Leakages (withdrawals) - (L) refer to the outflow of money from the economy e.g.

- Savings (S)
- Taxation (T)
- Payment for Imports (M)

Injections – (J) refer to the inflow of money into the economy e.g.

- Investment (I)
- Government expenditure (G)
- Payment for exports (X)

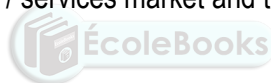
When will the economy be in equilibrium? When injections are equal to leakages, thus when $L = J$.

Which formula is used to calculate the GDP of a country?

$GDP = C + I + G + (X - M)$ where GDP is the value of all final goods and services produced within the borders of a country for a specific period.

Interaction of markets in the Circular Flow Model

The model shows how the household sector, the public sector, the business sector as well as the foreign sector interacts with one another in an open economy. They are all economic participants. We also observe 3 markets in the model i.e. the factor market, the goods / services market and the financial market.



The product and factors markets

Product / Service market – a market where goods and services are exchanged, e.g. consumer and capital goods.

Factor market – represents the amount received by the various factors of production e.g. in the labour and capital markets.

The money and financial capital markets

Financial sector or market – this sector represents those financial institutions (e.g. banks, pension funds, JSE, insurance companies) who are not directly involved in the production of goods and services but act as a link between households and firms. The money market - is the market for short-term and very short-term savings and loans.

Discuss the impact of each participant in the economy.

- **NB:** - when studying roles of the economic participants it is very important to include within the discussion the impact that participants have in the economy
- The impact can be both negative and positive
- Discuss how each participant impact the economy?

This is how you can answer this question, for example

Households: **positively** impact the economy by increasing aggregate demand leading to increase in the economic growth. **Negatively** affect the economy as excessive demand leads to inflation.

Businesses: create more job opportunities leading to an increase in the economy

Private sector must be competitive in the economy

Government: Improves infrastructure and provides service delivery to the public

Foreign sector improves the trade balance if more goods/services are exported. It worsens the trade balance if imports exceed exports

Activity 1

Recap the day's lesson where learners complete the blank spaces on the diagram: 10 x 2 = (20)

Activity 2

2.1 Give two examples of participants in an open economy (2)

2.2 What role do financial institutions play in the circular flow (2)

2.3 Study the table below and answer the questions that follow.

Component	R billion
Government Spending	100
Savings	100
Exports	100
Taxes	80
Imports	110
Investments	110

2.3.1 Give TWO examples of injections in the circular flow. (2)

2.3.2 Give an example of a leakage and an injection from the table. (2)

2.3.3 Distinguish between leakages and injections. (2x2) (4)

2.3.4 When is the economy in Equilibrium? Show by means of clear calculations whether the above economy is in /not in equilibrium. (2)

2.4 Tabulate the differences between goods and factor markets (8)

2.5 Differentiate between real flows and money flows in the circular model (8)

2.6 Explain the interaction of the economic participants in the macro-economic circular flow. (8)

2.7 How does the financial sector contribute to the South African economy? (8)

TOPIC: NATIONAL ACCOUNTS AGGREGATES

Key concepts

National account is an accounting record of a country total production, income and expenditure

It is used to measure economic activities of a country i.e. GDP

Final goods- are goods that are ready for consumption by the participants in the economy.

Intermediate goods- are goods that are used as inputs to produce other goods and services

Double counting: occurs when intermediate products are added to final products and will cause national accounts to reflect an incorrect higher total

Residual item – balancing item due to errors and omissions

Taxes on production –refers to taxes on production not linked to a specific product taxes on land and building taxes are payable corporate tax

Taxes on product- are payable per unit of some good and service eg VAT

Subsidies on production- it refers that are not linked to specific goods and services eg subsidy made on production

Subsidies on product- financial incentives to help struggling industries produce, as well as direct subsidies payable per unit exported

Gross Domestic Expenditure

Gross national income (GNI)-total remuneration for the factors of pro

Real GDP- it is the referred to as GDP at constant prices, real GDP are adjusted for price changes

Nominal GDP- it is referred to as the GDP at current prices, it gives the current value of the price.

GDP Deflator: it's a ratio of GDP at current prices to the GDP at constant price for a particular period

Formula for GDP Deflator: $\text{Nominal GDP} \div \text{Real GDP} \times 100$

Reasons for calculating GDP Deflator are to eliminate the effect of price changes to get the actual GDP not distorted by inflation

GDP is a **total value** of all **final** goods and services produced within the borders of a country in a specific in a specific period

Aggregate means total

There are **three methods** that are used to measure the national accounts

The income method: remuneration for the factors of the factors of production that have been used in the production of goods and services

The production method/ value added method: value of all the final goods and service produced in the primary, secondary and tertiary sector

Expenditure method: total expenditure on final goods and services within the borders of a country

Differentiate between domestic production and national production.

Domestic production (GDP) is the production that takes place within the borders of a country. It does not matter whether production is by South African or foreign firms.

National production (GNP) is the output of a country produced by the factors of production owned by the permanent residents of that country, regardless of where the production takes place.

In order to compare the GDP of one year with that of another, the nominal (current GDP which include the effect of inflation) has to be changed to a real (constant) GDP as follows:

Nominal GDP x 100 / deflator

Thus to calculate the **real GDP** the index should be deflated, that is, removing the effects of inflation since the base year.

How can national income figures be expressed?

National income figures can be expressed at **market prices, basic prices and factor cost**, depending on which approach is used to calculate the GDP of a country.




In the national accounts there are two types of taxes namely

- **Taxes on production** – refer to taxes on production not linked to a specific good or service (e.g. tax on land and buildings, business licensees, payroll taxes).
- **Taxes on products** – taxes that are payable per unit of some good or services (e.g. VAT, import duties, tax on imports and exports).

The national accounts reflect two types of subsidies namely

- **Subsidies on production** – subsidies that are not linked to specific goods or services, e.g. subsidy on employment.
- **Subsidies on products** – financial incentives to help struggling industries to produce, and direct subsidies payable per unit exported, to encourage exports (e.g. government subsidy on bread).

National account aggregates show the total (aggregate) value of **income, expenditure and production** in a country, In short they can be summarised as **PIE**, illustrated below (the 3 methods in calculating the GDP):

PRODUCTION METHOD	INCOME METHOD	EXPENDITURE METHOD
		
GDP	GDP	GDP
Adds final values of all goods and services produced	Adds all income earned by owners of factors of production	Adds spending of four main economy sectors – consumption, government, investments and exports (minus imports)

Source: *Mind the Gap, DBE*

The **production method** is a method whereby we determine the Gross Domestic Product - GDP (P) - at market prices by adding the final values of all goods and services produced, calculated as **gross value added**.

The **income method** is a method whereby we determine the Gross Domestic Product - GDP (I) - at market prices by adding all the income earned by the owners of the factors of production (gross domestic income).

The **expenditure method** is a method whereby we determine the gross domestic product - GDP (E) - at market prices by adding the spending of the four major sectors of the economy - consumption, government, investments and exports (minus imports).

Let's do an example of the different methods in calculating the national account aggregates.

- What does the **expenditure method** calculate or add?

The expenditure method adds up all the money spent in the country by households, firms, government and the foreign sector on final goods and services. Calculation yields **GDP at market prices**.

Spending within borders of South Africa	2014	2015	2016	2017
Final consumption expenditure by households	2 282 036	2 417 271	2 585 839	2 764 397
Final consumption expenditure by government	791 348	828 934	905 164	973 820
Gross Capital formation	780 077	849 975	841 920	863 330
Residual items	8 862	7 425	-9 348	-17 134
Gross domestic expenditure	3 853 462	4 096 180	4 332 923	4 601 547
Export of goods and services	1 197 492	1 221 748	1 335 659	1 384 971
Less imports of goods and services	1 254 466	1 273 933	1 308 919	1 317 599
Gross domestic product @ market prices	3 805 350	4 051 421	4 350 314	4 651 785

Source: South African Reserve Bank, Quarterly Bulletin, Dec, 2018

This table shows that South Africa exported more goods and services than it imported in 2017. This caused an injection from the circular flow to the value of about R 67 372 billion in 2017.

- What does the **income method** calculate or add up?

The income method add up all the money earned by households as remuneration for the factors of production, that is, by adding the amount of money earned through wages, rent, interest and profits. Calculation yields **GDP at factor cost**.

Activity 3

3.1 Study the table (data response question) below and answer the questions that follow:

CALCULATION OF GDP ACCORDING TO THE INCOME METHOD	
	<i>R billion</i>
Compensation of employees	1 686
Net operating surplus	1 288
Consumption of fixed capital	510
Gross value added @ A	3484
Taxes on production	70
Subsidies on production	12
Gross value added @ basic prices	B
C on products	462
Subsidies on products	12
Gross domestic product @ market prices	3992

- 3.1 Which component contributed the most to the GDP? (2)
- 3.2 What is the alternative term used for GDP in the national accounts? (2)
- 3.3 Name the financial institution responsible for the publishing of the GDP figures in South Africa? (2)
- 3.4 Give a reason why the GNP figures in South Africa are generally lower than the GDP figures. (2)
- 3.5 Provide labels for A and C. (4)
- 3.6 Differentiate between GDP and GNP. (4)
- 3.7 Calculate the gross value added at basic prices (letter B.) (4)

Activity 4

4.1 Study the data in the fictitious table on main aggregates and answer the questions that follow:

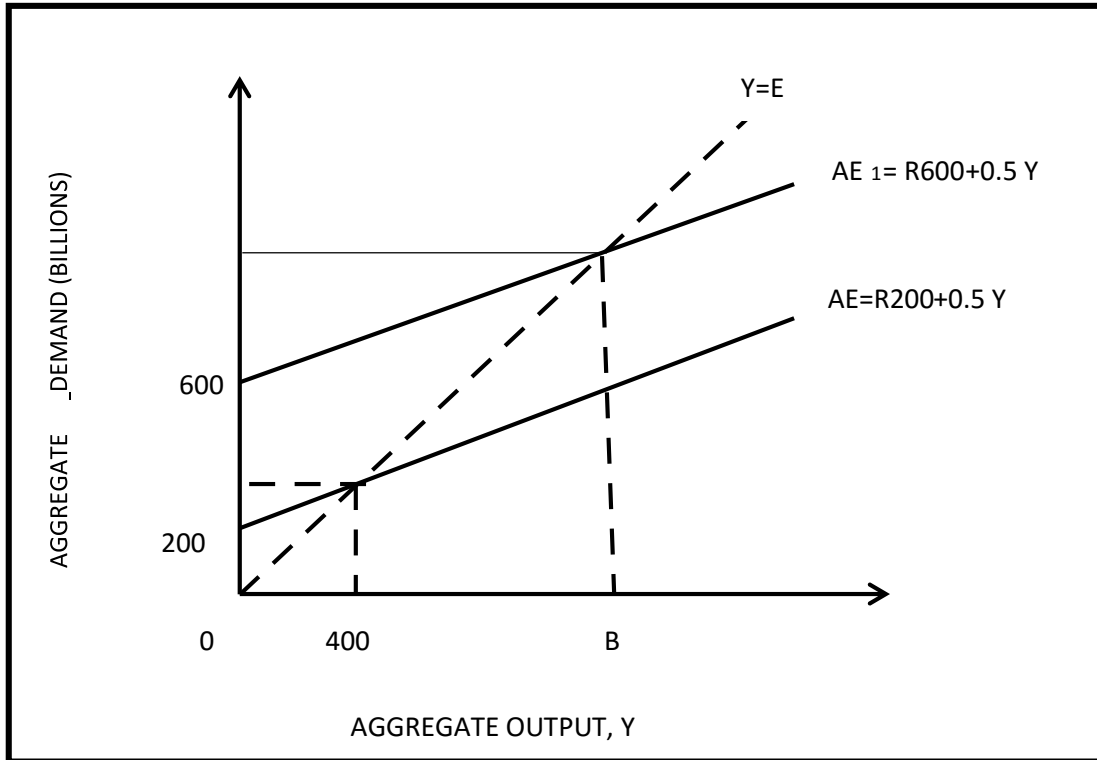
	Billions of Rand
Remuneration of employees	312
Other tax on production	72
Subsidies on products	6
Factor payments from the rest of the world	3
Factor payments to the rest of the world	11
Consumption of fixed capital	79
Tax on products	83
Other subsidies on production	7
Net operating surplus	138

- 4.1.1 Which method was used in the above table to calculate the GDP? (2)
- 4.1.2 Name any other two methods that can be applied to calculate GDP. (4)
- 4.1.3 Calculate the GDP at factor cost. Show all the calculations. (4)
- 4.1.4 Calculate the GDP at market price. Show all the calculations. (4)
- 4.1.5 The GNP (gross national product) differs from the GDP. Calculate the GNP at market prices. (4)
- 4.2 Explain why South Africa is very popular among other nations as a place to employ human and physical capital. (4)
- 4.3 Indicate which national account figure you will use for information on the following:
- 4.3.1 A change in the production of goods and services inside the borders of a country.
- 4.3.2 The level of production of goods and services inside the borders of a country.
- 4.3.3 The level of domestic expenditure inside the borders of a country.
- 4.3.4 The expenditure on the goods and services produced inside the borders of a country.
- 4.3.5 The income earned by the factors of production inside the borders of a country.
- 4.3.6 The value of goods and services produced by the citizens of a country. (6x1) (6)



ACTIVITY 5

5.1. Study the graph below that depicts a simplified economy ($E = C+I$) and answer the questions that follow.



- 5.1.1 What is depicted by the above diagram. (1)
- 5.1.2 Name the type of economy shown by the above graph (1)
- 5.1.3 Describe the term *marginal propensity to save* (2)
- 5.1.4 How can the government influence the size of the multiplier? (2)
- 5.1.5 Use the formula $k=1/1-mpc$ to calculate the value **B** for the above scenario. (Show all calculations) (2 x 2) (4)
- 5.2 With an aid of a diagram, discuss the multiplier effect. (8)
- 5.3 Evaluate the factors affecting the size of the multiplier (8)

TOPIC: BUSINESS CYCLES

Key concepts:

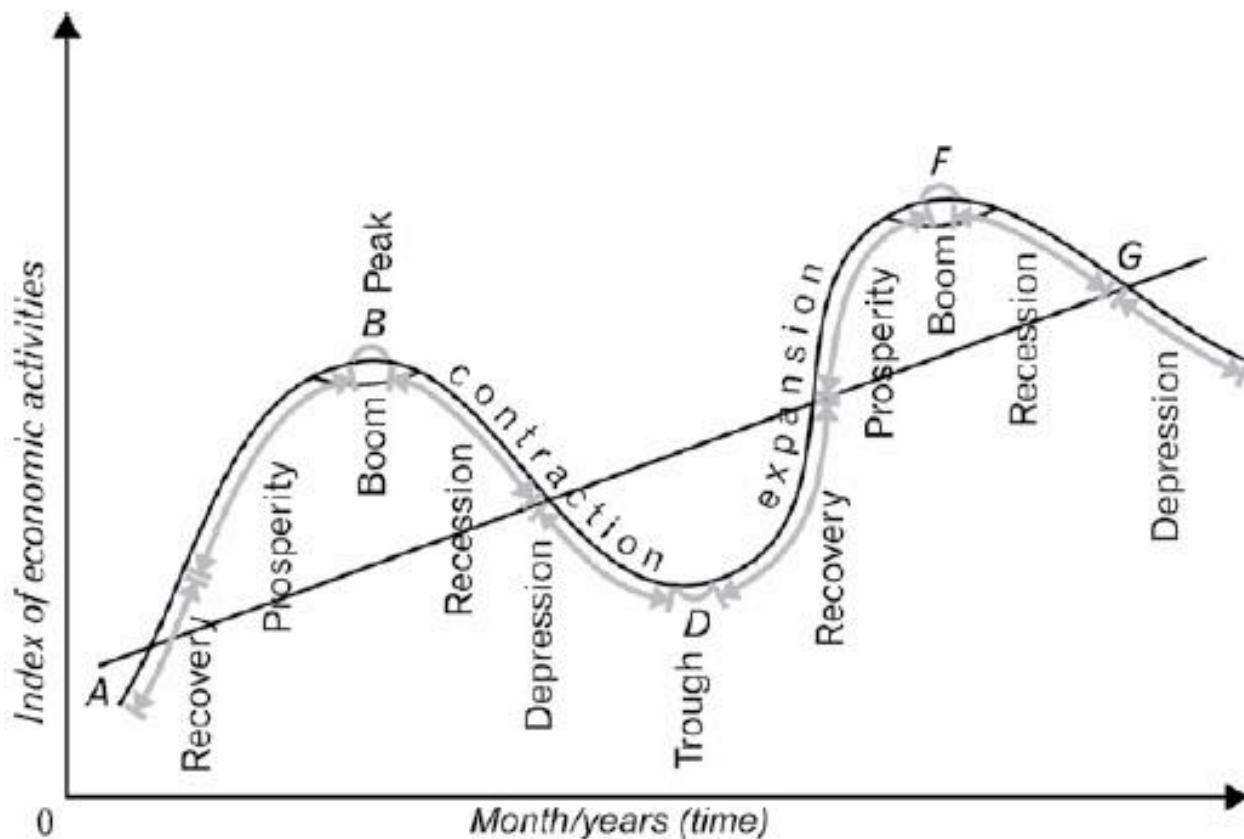
Term	Definition
Business cycle	Successive periods of growth and decline in economic activities
Depression	Economic activity is at its lowest. Deepening of the recession
Economic indicator	Used to measure trends in the economy, e.g. GDP
Peak	Point where the economic expansion is at its highest
Philips-curve	Illustrates the relationship between unemployment and inflation
Recession	A negative economic growth for at least two quarters
Trough	Point where the economic contraction is at its lowest

Definitions

- Business cycles is an increasing and decreasing of economic activities.
- Business cycles is the upward and downward movement of levels of gross domestic product (GDP).
- Business cycles are successive periods of fluctuations in economic activity.

Actual (Real) Business cycles is obtained when the effect of seasons, irregular events and the long –term growth trend are removed from the time series.

The composition of the business cycle



Source: *Mind the Gap*, page 16

The above graph shows economic activity over an extended period of time as the economy moves between periods of expansion (recovery/prosperity) and periods of contraction (recession/depression).

Features

- The business cycle oscillates between the upper (peak) and lower (through) turning points.
- A period where there is a general increase in economic activity is known as an upswing.
This is the entire period from the through to the peak.
- A period where there is a general decline in economic activity is known as a downswing.
This is the entire period from the peak to the through.
- Peaks are the high points on a business cycle. The period immediately before and through the upper turning point of the cycle is called the boom.
- **Troughs** are the lower turning points on a business cycle. The period immediately before and through the lower turning points of the cycle is known as the slump.
- **The length of a business cycle** is the distance from one peak to the next peak or from one through to the next through.
- **Amplitude** is the vertical distance between a trough and the next peak.

- **The trend-line** may be positively sloped (when the GDP is rising), horizontal (when the GDP is staying the same) or negatively sloped (when the GDP is falling). Thus indicating the expected growth rate of a country.
- **Extrapolations** – is a technique used to predict the future by using past data
- **Moving averages** – are used to minimize the effect of short-term fluctuations. The aim is to highlight the long term movements when dealing with time series data.

What is the difference between the expansion phase and the contraction phase that could appear on a business cycle?

Expansion is characterised by growth in real GDP, income and employment. It consists of two phases i.e. the recovery and prosperity (also known as the boom) phase. Firms make high profits and this attracts other businesses to enter or the firms expand in the market. As more businesses open, more factors of production (e.g. labour) are employed. The increase in income causes an increase in aggregate demand which in turn forces producers to increase their output. This causes an increase in investment spending as producers expand their businesses and buy more inventories.

Contraction is a period of gradual decline in economic activity. There is a decrease in aggregate demand that forces a decrease in output. The decrease in sales leads employers to reduce employment and income decreases. There is a downward spiral of real GDP (output), employment, income, standard of living, etc. This period consists of two phases i.e. recession and depression.

When will a recession kick in?

When there is a continuous decrease in economic activity for a period of six consecutive months (or two quarters).

Causes of the business cycle

There are numerous theories as to the causes of business cycles. Among these are the Monetarist approach and the Keynesian approach. The government uses monetary instruments such as interest rates to mediate these business cycles.

- **The Monetarist (exogenous) approach.**

Exogenous variables are similar to **independent** or explanatory variables. They are used in a theory to explain other things but they are not themselves explained by the theory. This follows the belief that economic growth arises due to influences outside the economy or business of interest, markets are inherently stable. When disequilibrium occurs, market forces kick in and bring the market back to its equilibrium route, government should not intervene.

Exogenous factors are factors that originate from **outside** the domestic economic system. Examples are technology advances, climate conditions affecting production, political shocks and unexpected events that can act as a trigger mechanism for a contraction or expansion.

- **The Keynesian (endogenous) approach**

Endogenous variables are **dependent** variable. This follows the belief that economic growth is primarily the result of

Endogenous and not external forces, markets are inherently unstable and prices are not flexible enough.

Endogenous factors are factors that are **inherent** to the economy, markets are inherently unstable and that business cycles are part of the way market economies operate. They say that changes in investment spending and consumer spending bring about changes in the demand for output.

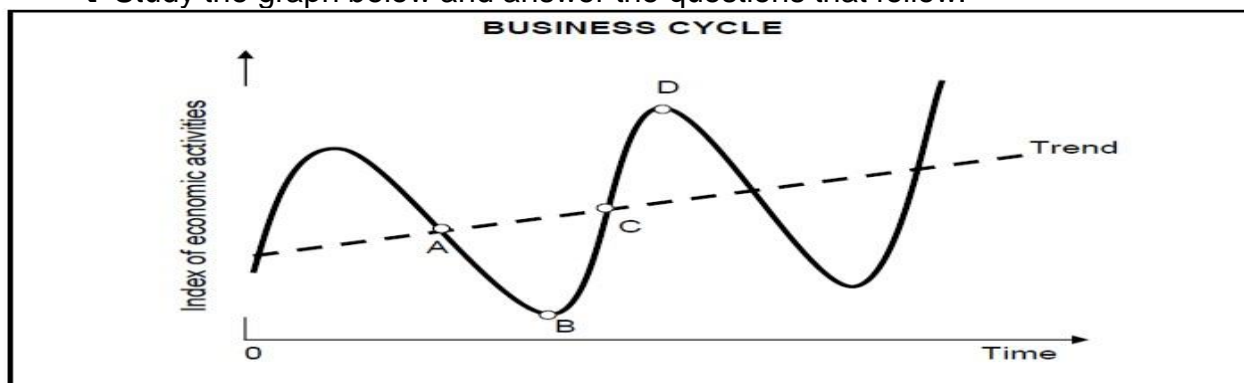
Structural explanations for business cycles

Kinds of business cycles- names, periods and economic activities

- **Kitchin cycles** – These cycles last between **three and five years** and are thought to be caused by businesses **adapting their inventory levels**.
- **Juglar cycles** – These cycles last slightly longer, **from seven to eleven years** and they are thought to be caused by **changes in net investments by businesses and the government**.
- **Kuznets (Building) cycles** – These are caused by **changes in activity in the building and construction industry**. They are usually **between 15 and 20 years**.
- **Kondratieff cycles** – These are **long cycles** because they describe **long term fluctuations in economic activity** – lasting **fifty years and longer**.

Activity 1

✚ Study the graph below and answer the questions that follow.



- 1.1 Name TWO turning points in the business cycle. (2)
- 1.2 What is indicated by the trend line? (2)

- 1.3 Describe the concept business cycle. (2)
- 1.4 Differentiate between endogenous and exogenous factors as economic (4)
- 1.5 How can the government stimulate economic activity in an effort to smooth out business cycles? (4)

ACTIVITY 2

1.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter next to the question number.

1.1.1 A business cycle estimating something unknown from information that is known is called...

- A. amplitude
- B. extrapolation
- C. trend
- D. moving averages

1.1.2 Negative economic growth for at least two consecutive quarters is known as a....

- A. boom
- B. depression
- C. recession
- D. trough

1.1.3 Indicators which change before the business cycle change are called.....

- A. leading
- B. lagging
- C. coincidence
- D. upswing



1.1.4 Business cycles are in the shape of...

- A. Circles
- B. waves
- C. a line graph
- D. triangles

1.1.5 The new economic paradigm is embedded in ... policy/policies.

- A. demand – side
- B. supply – side
- C. demand and supply side
- D. slump –side

1.1.6 Fiscal stabilization policies of the business cycles are ... in nature.

- A. countercyclical
- B. pro-cyclical
- C. cyclical
- D. geographical

1.1.7 During an economic recession

- A. unemployment will increase
- B. production increases
- C. spending decreases
- D. consumption increases

(7 x 2) = [14]

1.2 Choose a description from column B that matches an item in Column A. Write only the letter next to the question number.

COLUMN A	COLUMN B
1.2.1 Moving average 1.2.2 Business cycle 1.2.3 Depression 1.2.4 Keynesian approach 1.2.5 Coincidence indicator 1.2.6 Forecasting 1.2.7 Fiscal Policy 1.2.8 Extrapolation	A. Predictions about the future behaviour business cycles B. Interventionists that hold the view that markets are inherently stable C. The policy that is applied by the government in its endeavor to ensure the economy is run according to best possible practice. D. The tool that is used smooth the business cycle in order to get a better picture of the general trend. E. The graph that represent the level of economic activity in a country. F. A phase where many businesses closedown, resulting in very low output. G. A technique used to predict the future based on previous knowledge. H. Changes at the same time as economy. I. It shows the severity of each phase of the business cycle

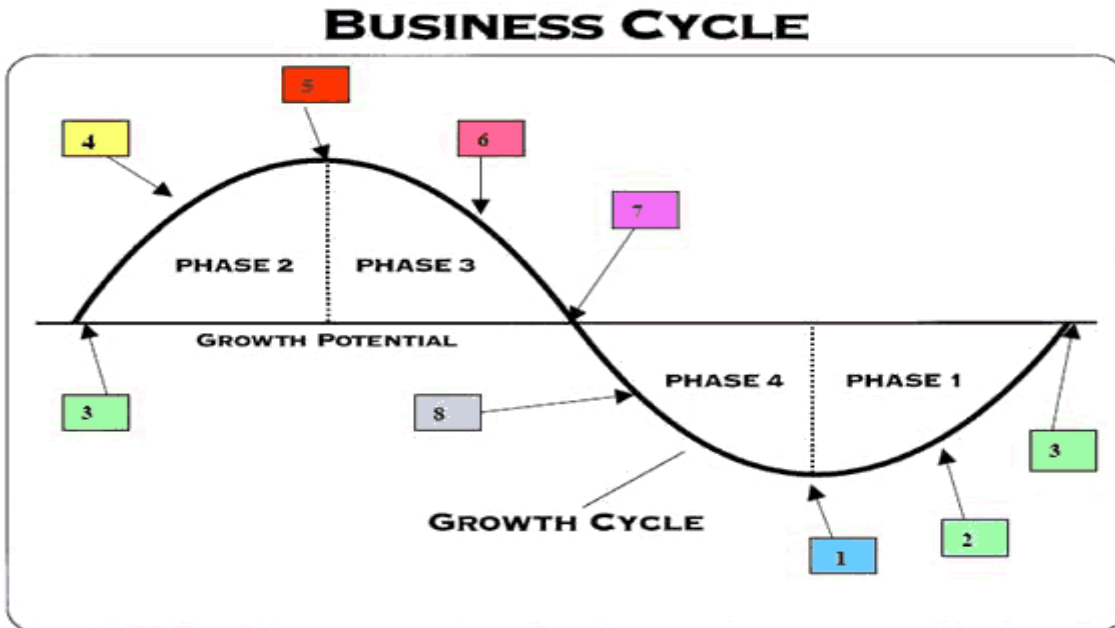
1.3 Give one term for each of the following descriptions. Write only the term next to the question number (1.3.1 – 1.3.6)

- 1.3.1 The graph/curve used to illustrate the relationship between unemployment and inflation
- 1.3.2 Focusing on variables outside the market system being explained.
- 1.3.3 The investment in capital goods is an example of this indicator.
- 1.3.4 The term used to describe the vertical distance between the trend line and turning points of the business cycle.
- 1.3.5 The ability of a firm or industry to adapt quickly to changes in consumer demand and technology.
- 1.3.6 An economic theory that stresses that economic growth depends on the stimulation of aggregate supply.

[30]

ACTIVITY2:

- 2.1.1 Name any two main aims of fiscal policy (2x1) [2]
- 2.1.2 What is the purpose of the Trend line in a business cycle? (2x1) [2]
- 2.2 Study the diagram below and answer the questions that follow.



- 2.2.1 What type of growth does the above trend line indicate? (2)
- 2.2.2 Name the phase represented along no 6 and 7 on the graph above (2)
- 2.2.3 Describe the term Lagging indicators? (2)
- 2.2.4 Explain how the government can use contractionary measures to depress a heated economy. (4)
- 2.3. Explain stagflation in the context of business cycles (8)
- 2.4. Discuss a Phillips curve, using a well labelled graph as an instrument of the demand-side policy. (8)

Activity 3

3.1 Study the cartoon below and answer the questions that follow.



- 3.1.1 Which economic phenomenon is represented by the cartoon above. (1)
- 3.1.2 Name the turning point illustrated by the above source. (1)
- 3.1.3 Briefly describe the term real (actual) business cycle. (2)
- 3.1.4 What impact will the above economic situation have on employment rate? (2)
- 3.1.5 How can South African Reserve Bank intervene in the situation above? (2X2) (4)
- 3.2 Distinguish between *exogenous* and *endogenous* causes of business cycle. (8)
- 3.3 How can length be used in forecasting of business cycle? (8)

Activity 4

4.1 Study the cartoon below and answer the questions that follow.



- 4.1.1 Name the economic condition depicted by the above cartoon. (1)
- 4.1.2 What will job growth contribute to the economy? (1)
- 4.1.3 Describe the term prosperity phase. (2)

- 4.1.4 Explain fiscal policy as an instrument that is used to smoothen business cycle. (2)
- 4.1.5 How can SARB use monetary policy to curb inflation? (2X2) (4)
- 4.2 Explain the relationship between inflation and unemployment using the Phillips curve. (8)
- 4.3 How can the monetary policy be used to stimulate the economy? (8)

Activity 5

5.1 Study the cartoon below and answer the questions that follow.



- 5.1.1 What type of government intervention is used in the cartoon above? (1)
- 5.1.1 Name one measure implemented by the government to correct the above economic condition. (1)
- 5.1.1 Briefly describe the term *deregulation*. (2)
- 5.1.2 Explain the influence of interest rate at initial stages of economic recovery? (2)
- 5.1.3 How tax reduction stimulates economic recovery? (2X2) (4)
- 5.2 Distinguish between the *amplitude* and *trend* of the business cycle. (8)
- 5.3 How can government stabilize the business cycle? (8)

Public Sector

Key concepts:

Term	Definition
The budget	A document that details expected revenue and projected expenditure
Bureaucrats	An official in a government department
Central national government	Concerned with national issues, e.g. safety and security
Collective goods	E.g. parks and public utilities. Free riders or people who do not want to pay can be excluded by levying fees
Community goods	E.g. police stations. Everyone can use these whether they are prepared to pay for them or not
Demerit goods	Harmful goods, e.g. cigarettes
Deregulation	Removal of unnecessary restrictions by law
Direct taxes	Taxes that are not shifted to the end user, e.g. PAYE
Indirect taxes	Taxes levied on the sale of goods and services

Local government	Deals with local issues within a town or municipal area
Merit goods	Goods and services whose provision has more public benefit than private benefit, e.g. health
Monetary Policy Committee (of the Reserve Bank) (MPC)	Decides on the country's monetary policy
Medium Term Budget Policy Statement (MTBPS)	Government's statement setting out its three-year budget
Medium Term Expenditure Framework (MTEF)	Estimates income and expenditure for a three-year period
Nationalisation	Transfer of functions and ownership from the private sector to the public sector
Public goods and services	Provided by the state for use by all the members of a society, e.g. public libraries
Regional government	Deals with economic and other issues specific to a region/province
Regulation	Putting laws in place to regulate activities
State Owned Enterprises (SOE)	A business owned wholly or partly by the state and run by a public authority, e.g Eskom and SAA
Value Added Tax (VAT)	An indirect tax on goods and services consumed in the economy

The composition and necessity of the public sector.

A. Levels (spheres) of government

- **National government** is that part of the public sector responsible for the overall running of the country and deals with national issues such as safety and security, foreign affairs and international trade. In South Africa the national government includes the President, Cabinet Ministers and Members of Parliament. The

government is responsible for national issues such as defense, education, health, housing, safety and security. Central government also includes public service organizations such as the CSIR and SABS.

- **Provincial government** forms the part of the public sector that deals with economic issues specific to a given region or province. Provincial government receives a budget from national government, but they also generate their own income, mostly from taxes. They draw up frameworks for developing the economy of the province and improving services such as housing, health clinics and education.
- **Local government** forms the part of the public sector that deals with local issues within a town or municipal area. These include municipal roads, libraries, traffic control and refuse removal.

B. State-owned enterprises (SOE) -These enterprises are created by government to undertake commercial activities on behalf of government to provide public goods and services (e.g. electricity), also referred to as parastatals.

C. Public-private partnerships- is whereby the government forms partnerships with private sector in order to provide public goods and services efficiently.

Necessity/ reasons for government to intervene in the economy.

It provides the structure and law and order that allow society to exist.

The public sector determines the policies they believe will improve the living conditions and lives of the citizens.

The public sector puts policy into action. It must deliver services and enforce law and order.

Adam Smith argued that the government has three main duties namely:

- To protect its citizens against external threats.
- To maintain law and order within the country.
- To provide certain goods and services which are needed by the citizens, but which are not profitable for entrepreneurs to provide.

The government intervenes in South Africa's mixed economic system when there is market failure.

Market failure occurs when **the free market forces of demand and supply fail to lead to an efficient allocation of resources.**

Role of the public sector

- **The provisioning of public goods and services**
- Public goods are non-rival in consumption
- It is not possible to exclude individuals from using public goods
- Public goods are non-rejectable

- Collective goods: goods for which it is possible to exclude free riders by levying fees or tolls
- **To conserve common resources:**
 - Negative externalities
 - Positive externalities
- **To manage the economy:** To protect consumers from monopolies.
 - The promotion of merit goods and the restriction of demerit goods

Now we will discuss the necessary reasons why government should intervene in the economy.

- **The provisioning of public goods and services**

Public goods/services are also known as community goods/services e.g. public roads, national defense and streetlights, which are not provided by the private sector in a mixed economic system.

The following characteristics of public goods and services can be studied:

- **Public goods/services are non-rivalry in consumption**

Take a litre of Coke as an example. When one person has consumed the litre of Coke, it cannot be used by another person.

Such goods are said to be rivalries in consumption. Some goods can be divided into sale-able units and are therefore non-rivalries in consumption. Some examples are streetlights. They can still be used by other consumers without being used up. These goods/services are also known as communal goods/services.

- **It is not possible to exclude individuals from using public goods/services**

A good example will be the Union Building's park. It is impossible to prevent individuals from enjoying the city's views, while having a picnic. Also known as collective goods.

Now the problem of free riders could arise, where individuals realize they could still benefit from good/services without paying for it. A good example will be watching TV without paying your TV license.

Government try to overcome this problem of free riders by imposing compulsory payment in the form of taxes e.g. the tax levy on fuel consumption, which is included in the fuel prices.

- **Public goods are non-rejectable**

The third characteristic gives individuals the choice whether or not to consume the public product/service provided e.g. calling on the police force to remove criminals or choosing to pay a security firm to do this job.

- **Existence of externalities**

This is benefits or costs which result from the production of a good or service, but which are not reflected in the price of the product. Externalities are also known as spillover effects.

The consumption of a good/service could have positive or negative consequences.

A negative consumption of a good/service could be the depletion of natural resources or pollution.

A positive consumption of a good/service could be free education.

These negative and positive side effects of production and consumption are known as externalities. How could government assist in reducing these negative externalities and thus limit the damages or social costs?

Government could intervene by imposing taxes (increase their private costs) on e.g. paper producers, thus increasing their cost of production and then hoping they will limit their pollution. On the other hand, how could government assist in maximizing the benefits and encouraging the production of the good/service?

Government could subsidize the production of the good or service to lower the cost of production or government could produce the good itself.

- **The promotion of merit goods and the restriction of demerit goods.**

Differentiate between the concepts merit and demerit goods?

Merit goods are goods or services whose provision has more public benefit than private benefit.

Examples include healthcare, education, emergency services and sporting facilities.

Demerit goods are goods such as cigarettes, which are deemed socially and environmentally harmful. The government often takes steps to discourage consumption and production of these goods e.g. through sin taxes.

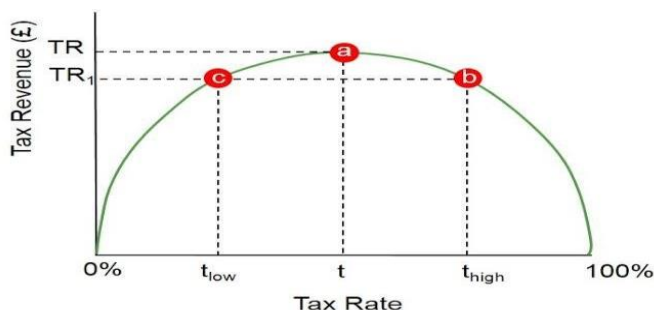


- **To protect consumers from monopolies**

When monopolies are formed, there is a potential for resources to be wasted and for consumer to pay higher prices for goods and services than they would if there was perfect competition in the market. The state intervenes and strives to protect consumers through fair trade and healthy competition.

Activity 1

1.1 Study the graph below and answer the questions that follow:



1.1.1 Identify the point at which government will maximize tax revenue. (1)

1.1.2 What illegal behavior by the workers will be encouraged if the tax rate is high? (1)

- 1.1.3 Briefly describe the *Laffer curve*. (2)
- 1.1.4 Explain the impact of an increase in direct tax rate on business. (2)
- 1.1.5 How can borrowing (state debt) be used as an instrument of fiscal policy? (4)
- 1.2 How does the government plan to divide Eskom into 3 units? (8)

Activity 2

2.1. Study the illustration below and answer the questions that follow:



- 2.1.1 Name the ministry responsible for all SOE's in South Africa. (1)
- 2.1.2 Why are SAA airlines facing downwards in the cartoon? (1)
- 2.1.3 Describe the term *public enterprise*. (2)
- 2.1.4 Explain the impact of SOE's failure on the state budget. (2)
- 2.1.5 How can the minister of public enterprise solve the challenges facing all SOE's? (4)
- 2.2 How can taxation be used to stimulate employment in South Africa? (8)

Activity 3

3.1 Study the illustration below and answer the questions that follow:



- 3.1.1 Name the problem of public sector inefficiency depicted in the above picture. (1)

- 3.1.2 Name one chapter 9 institution responsible for stopping the above problem. (1)
- 3.1.3 Briefly describe the term *rent seeking*. (2)
- 3.1.4 How can South Africa be freed from inequality? (2)
- 3.1.5 How can the parliament ensure greater state accountability? (4)
- 3.2 Evaluate the success of economic growth and price stability as a part of government's macroeconomic objectives. (8)

Activity 4

4.1 Study the extract below and answer the questions that follow:

THE MINISTER OUTLINES HIS MTEF

During the 2019 Medium Term Budget Policy Statement (MTBPS), I outlined our main budget fiscal outlook. At that time, I projected that in 2019/20 tax revenue would be R1.3 trillion and that spending would be about R1.5 trillion. That left us with a budget deficit of R215 billion, or 4.3 per cent of GDP. I said that we were at a crossroads, and that we could go either to heaven, or the other way. Then, we expected economic growth of 0.7 per cent in 2018. This is still our estimate. But, many of the risks that we warned about have materialized. We now expect a slower but still steady recovery after the 2018 technical recession. It is expected that real GDP growth in 2019 will rise to 1.5 per cent, and then strengthen moderately to 2.1 per cent in 2021.

Source: Business DAY, 22 November 2019)

- 4.1.1 During which month of the year does the minister outlines the MTBPS in parliament (1)
- 4.1.2 Name the main source for government revenue. (1)
- 4.1.3 Briefly describe the term medium *term expenditure framework*. (2)
- 4.1.4 Why is it important for the treasury to keep the deficit under 3% of the GDP (2)
- 4.1.5 How would the MTEF assist all stakeholders in long term planning? (4)
- 4.2 How does the South African government attempt to solve the problem of income inequality? (8)

Essay Questions

- 4.3 Discuss any FIVE problems of public sector provisioning in South Africa in detail. (26)
- How can the unfair distribution of income in South Africa be resolved? (10)
- 4.4 Discuss the macroeconomic objectives of the state in South Africa's economy. (26)
- Evaluate the extent to which South African government has achieved these objectives. (10)

TOPIC: INTERNATIONAL TRADE

Key Concepts

Absolute advantage, balance of payments, BoP disequilibrium, capital transfer account, comparative advantage account, current transfers, demonetization, debt forgiveness, direct investment, exports, financial account, free trade, imports, globalization, international trade, international monetary fund, international trade, monetization, net balance, net trade, opportunity cost, portfolio investment, reserves account, special drawing rights, specialization, terms of trade, trade balance, trade deficit, transfer payment, trade surplus, unrecorded transaction, financial derivative

DEMAND REASONS FOR INTERNATIONAL TRADE

Size of population

- An increase in population creates a need for more goods and services.
- Local suppliers may not be able to satisfy the needs and wants for the growing population.
- As a result, members of the population can import some of the goods and services from other countries.



Income levels

- An increase in people's income will increase the demand for goods and services.
- This will also result in the demand for goods and services that are produced in other countries.

Change in the wealth of the population

- An increase in wealth of the population leads to greater demand for goods.
- People who have access to loans can spend more on luxury goods, many of which are produced in other countries.

Preferences and taste

- Tastes and preferences differ from person to person.
- People need a variety of goods and services.
- If goods and services are not available in the country it will lead to international trade.

The difference in consumption patterns

- Consumption patterns differ from country to country.

- People in well developed countries have a higher demand for luxury goods which they can easily buy in other countries.
- Poor people in developing countries have a high demand of basic goods and services.

SUPPLY REASONS FOR INTERNATIONAL TRADE

Natural resources

- Natural resources are not evenly distributed across the earth.
- If a country without a particular natural resource needs that resource it has to import the resource from the country that has it.

Climatic conditions

- Countries have different climates and certain crops can only grow in certain climatic conditions.
- Some countries cannot grow agricultural products they need, as a result, those countries have to import these products from countries that can grow them abundantly.

Labour and technological resources

- Countries that have skilled labour and technology can produce high-technology goods.
- These countries can export the goods they produce to other countries.

Specialisation



- Countries specialise in the goods that they can produce most efficiently and they then export some of such products.

BALANCE OF PAYMENTS (BOP)

The balance of payments is a systematic record of all transactions between one country and the rest of the world.

- Trade in goods
- Trade in services
- Income flows

ACCOUNTS IN THE BOP

1. CURRENT ACCOUNT

- It records transaction related to production, income and expenditure

- **Merchandise exports and imports:** record transaction on all visible goods (raw materials and intermediate goods, final goods) that South Africa export and import.
- **Net gold export:** shows the record of the income earned from the exportation of gold. While gold is a physical good it is recorded separately because of the amount of money that it earns as an individual product and South Africa relies heavily on it as an earner of income.
- **Services:** record money earned or spends on services such as insurance, transportation, recreational, professional.
- **Income:** Income earned by South African citizens from non- citizens and vice versa (non -South African citizens earning income from South African). It consists of two components which are **compensation of employees** e.g. salaries and wages and **investment income** e.g. dividends and profits.
- **Current transfer:** Items transferred from residents to non-residents and vice versa without any counter performance required e.g. gifts.

2. CAPITAL TRANSFER ACCOUNT

- It contains small amounts that move between countries as a result of the transfer of fixed assets and also grants of money from a foreign charity and money that migrants move.
- For example, when a foreign foundation gives a grant for HIV research, it is a transfer receipt (inflow). When a South African emigrates to Australia, the money she takes out of the country is a transfer payment (outflow)

3. FINANCIAL ACCCOUNT

Financial account consists of the following sub-accounts:

Direct investments

An investment in fixed property or the acquisition of a significant (10 % or more) share in a business.

Portfolio investment.

The purchase of financial assets e.g. shares on a shares market of another country.

Another name = “**hot money**” because it can be quickly converted into cash

Financial derivatives

An investment made in a specific asset with a fixed future value that is paid out on a specific date.

Other investment

Transactions that do not fall under direct, portfolio and financial derivatives, are classified as other investments e.g. short term loans

Reserve assets

Financial capital held by the monetary authorities such as the central bank to finance the trading disequilibrium.

Balance of payments format

1. CURRENT ACCOUNT

Goods exports
+ Net gold exports
+ Services receipts +
Income receipts
less Merchandise imports
less Payment for services
less Income payments
Current transfers (net receipts)
Balance on Current Account
Memo item: trade balance

2. CAPITAL TRANSFER ACCOUNT

NET LENDING TO (+) OR BORROWING FROM (-) REST OF THE WORLD

3. FINANCIAL ACCOUNT

Net direct investment
Net portfolio investment
Net financial derivatives
Net other investments
Reserve assets
Balance on Financial Account
Memo item: balance on Financial Account excluding reserve assets
Unrecorded transactions



Correcting disequilibria in the balance of payments

The solution to correct balance of payments disequilibrium lies in earning more foreign exchange through more exports and reducing imports.

Export promotion = government can help to promote exports

• Import substitution = government can help to reduce imports, making a country more self-reliant.

How can the BOP disequilibria be corrected? o Automatic corrections by the forces of demand and supply freely working towards equilibrium. o Deliberate measures by the government intervening and manipulating imports and exports

Which methods can the government implement to correct the disequilibrium on the BOP account?

- o Obtain assistance from the IMF, the World Bank and the WTO.
- o Promote tourism as this lead to an inflow of foreign currency.
- o Control foreign exchange by forcing exporters to change foreign currency to local currency.
- o Incentives (concessions) can be granted to local manufacturers and exporters.

- o Control of imports by imposing duties or by implementing a quota system.
- o Disposable income can be lowered by higher taxation. o Devaluating the local currency (Rand) to make exports cheaper and increase the price of imports.

ACTIVITY 1

1.1 Read the extract below and the questions that follow

BALANCE OF PAYMENT: CURRENT ACCOUNT RELEASE SEPTEMBER 2019

In the second quarter of 2019, the deficit on the *current account* of the balance of payments increased from R143.5 billion to R204.1 billion in the first quarter. South Africa's *trade balance* switched from a surplus of R41.9 billion in the first quarter of 2019 to a deficit of R27.2 billion in the second quarter.

The deterioration in the trade balance came about as the *value* of merchandise imports increased more than that of exports. South Africa's *terms of trade* (including gold) deteriorated in the second quarter of 2019 as the rand price of imports increased more than that of exports.

Source: SARB Quarterly bulletin 2019


- 1.1.1 Identify the concept, which shows that the current account balance was negative. (1)
- 1.1.2 Which institution grants special drawing rights? (1)
- 1.1.3 Briefly describe the term *trade balance*. (2)
- 1.1.4 Explain the importance of foreign direct investment in the economy. (2)
- 1.1.5 How can the South African economy benefit from international specialization? (4)
- 1.2 Explain by means of a graph the effect of the value of the rand if there is an increase in the number of South African tourists visiting the USA. (8)
- 1.3 Evaluate the impact of Free Trade in the South African economy. (8)

ACTIVITY 2

2. Study the table below and answer the questions that follow:

SOUTH AFRICA'S FINANCIAL ACCOUNT – 2018 to 2019		
	2018 Q4	2019 Q1
	R Billion	R Billion
Net direct investments	-31.5	-3.41
Net portfolio investments	-63.2	11.3
Net financial derivatives	3.9	-2.1
Net other investments	113.6	-15.8
Reserve assets	6.2	34
Balance on Financial Account	22.8	A

Source: SA Quarterly Bulletin 2019

- 2.1 .1 Name any ONE other account that forms part of the Balance Of payments. (1)
- 2.1.2 Identify an item that captures the effect of a foreigner purchasing (1)
- 2.1.3 Describe term *balance of payments*.  (2)
- 2.1.4 Why is gold export listed as a separate item in the Balance of payments. (2)
- 2.1.5. Calculate the balance on the financial account for 2019 1st quarter. (4)
- 2.2 Differentiate between *managed floating* and *free-floating* exchange rate systems. (8)
- 2.2 How can the South African Reserve Bank intervene in the foreign exchange market to stabilize the exchange rate? (8)

EXCHANGE RATES

PRIOR KNOWLEDGE: CIRCULAR FLOW (FOREIGN EXCHANGE MARKETS)

Key concepts

Foreign exchange market concepts

The foreign exchange market is a market where the currencies of different countries are exchanged, usually through the interaction of the demand for and the supply of currencies; also known as forex markets.

Forex – every country has its own currency (shorthand for foreign exchange).

When international trade occurs, imports have to be paid for in foreign currency.

Exchange rates – it is the price of one national currency in terms of another currency. It is the ratio at which one currency can be exchanged for another currency on the exchange market.

Fixed exchange rate – when a country fixes its currency to a quantity of gold or the US dollar, and announces a statutory exchange rate.

Revaluation – measure enforce by a government to increase the exchange value of the currency.

Devaluation – measure taken by a government to decrease the value of the currency.

Floating exchange rate – exchange rate determined by market forces of demand and supply.

Appreciation – an increase in the value of a currency in terms of other currencies as a result of market forces.

Depreciation – a decrease in the value of a currency in terms of other currencies because of market forces.

Foreign exchange control – these are various forms of control imposed by a government on the purchase or sale of foreign currencies by private residents.

Foreign exchange market – introduction

It is expressed (quoted) as the domestic price of one unit of a foreign currency, e.g. \$1 = R9.80 or R9.8000 (rates are quoted in four decimals in foreign exchange markets). The price of a Dollar, Euro and any other currency is expressed in terms of the Rand (domestic currency).

However, it can also be quoted the other way round, e.g. the foreign price of one unit of the domestic currency:

$R1 = (1 \div 9.8)$. The price of the Rand is expressed in terms of the dollar and other currency.

The first quotation is direct and the second one is indirect.

The leading exchange markets in the buying or selling of foreign exchange is situated in London, New York and Tokyo. These markets serve the world but they are interlinked with regional and country markets.

Differences in currencies

Every country has its own currency, e.g. the US Dollar, the British Pound, the Japanese Yen, the French Franc, the Chinese Yuan and the Botswana Pula.

A currency is a legal tender only in the country of origin. Trading blocs sometimes use a single currency, e.g. member countries of the European Union use the Euro.

The US dollar serves as a base currency worldwide.

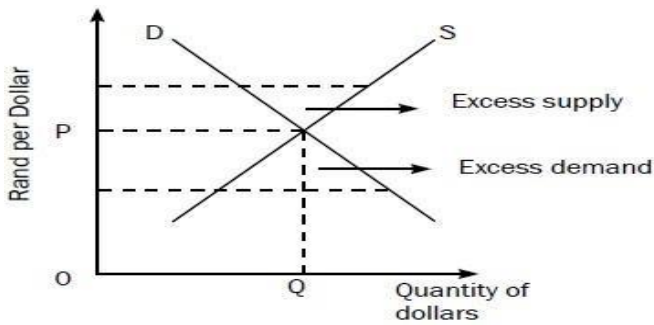
The demand for and supply of foreign exchange on forex markets

Imports create a demand for forex. An importing country such as South Africa will have to pay for imports with dollars, Euros or other currencies.

Where the demand for and supply of foreign exchange are equal, the foreign exchange market is in equilibrium

Demand of foreign exchange

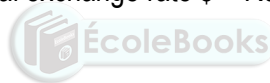
GRAPH



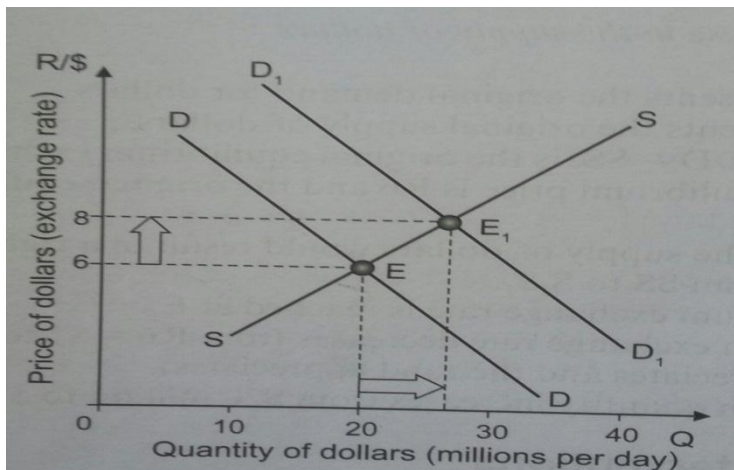
DD represent original demand for dollars

SS represent original supply of dollars

Point E where DD is equal to SS is the original exchange rate \$ = R6 □ Original equilibrium quantity of US dollars is 15 dollars



SHIFT IN THE DEMAND CURVE

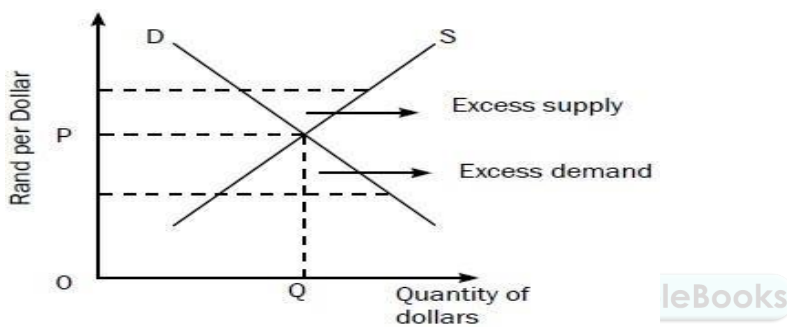


- The new demand curve of the dollar is D_1D_1
- Point E_1 is the new equilibrium where the exchange rate is $\$1 = R8$
- The new equilibrium quantity of US dollars is 25 dollars

The demand for foreign exchange is determined by:

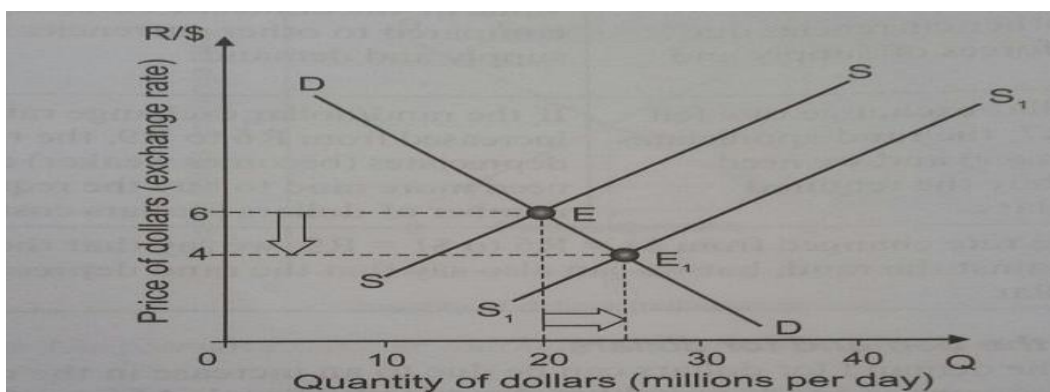
- Importing goods and services from foreign countries
- Services from foreign countries to the country concerned
- Payments of interest and dividends on loans and foreign investments
- Payments of instalments on repayment of overseas loans
- Tourists or representatives pending money in foreign countries
- Outflow of capital to foreign countries

SUPPLY OF FOREIGN EXCHANGE



- DD is the original demand of the US dollars.
- SS is the original supply of the US dollar.
- Point E where DD = SS is the original equilibrium exchange rate \$1 = P
- Original equilibrium quantity of the US dollars is Q dollars

INCREASE IN SUPPLY



- The new supply curve is S_1S_1
- Point E_1 is the new equilibrium where the exchange rate is $\$1 = R4$
- The new equilibrium quantity is 25 dollars

The supply of foreign currency is determined by:

- Exporting goods and services to foreign countries
- Receiving interest and dividend on loans and foreign investments
- Inflow of foreign capital
- Expenditure of money by tourists
- Other receipts received from foreign countries
- Rendering services to foreign countries
- Repayment (by foreign countries) on loans made in South Africa
- Investments made by foreign countries in South Africa



EXCHANGE RATE SYSTEMS

Free floating

- Exchange rates that are determined by the market forces (demand and supply).
- Exchange rate disequilibrium is controlled by the market through its self-correcting mechanism.
- There is no government intervention through the SARB. SA uses a free floating exchange rate system.

Managed/ controlled floating

- It is when the market forces (demand and supply) are allowed to influence exchange rates but up to certain levels.
- There is an intervention of the government from time to time to stabilize exchange rates.
- The central bank through buying and selling of foreign currency

Fixed exchange rates

- Determined and prescribed by the government.
- Government intervention leads to stable exchange rates that benefit investment and trade between countries.
 - Exchange rates are fixed for a short period. There is revaluation and devaluation.

TERMS OF TRADE

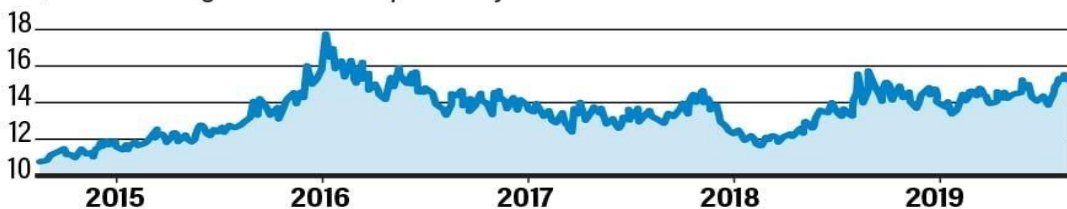
- Ratio between export and import prices, expressed in the form of an index.
- **Increase in terms of trade** – when export prices are higher than import prices.
- **Decrease in terms of trade** – when import prices are higher than export prices (disequilibrium)

Activity 3

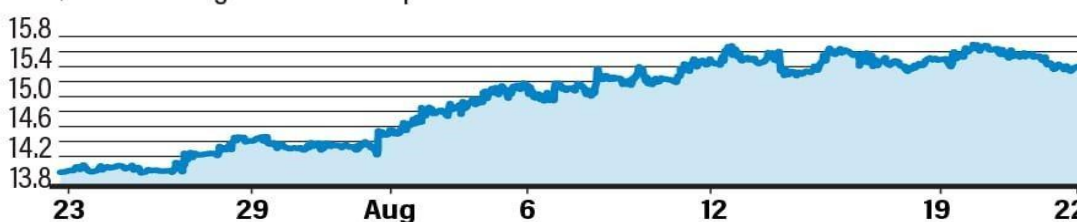
Study the graph below and answer the questions that follows

RAND EXCHANGE RATE

US\$-ZAR exchange rate over the past five years



US\$-ZAR exchange rate over the past month



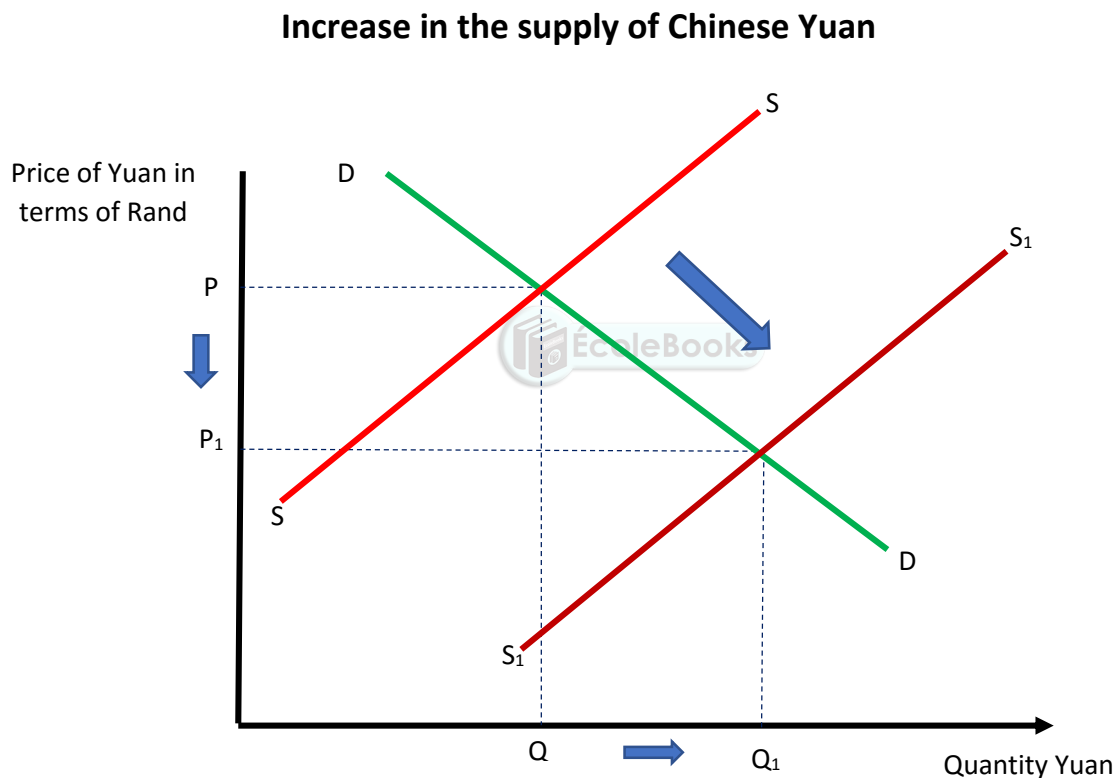
Sources: tradingeconomics.com

- 3.1.1 Name the country that uses ZAR as its currency. (1)
- 3.1.2 What type of exchange rate system is determined purely by the market forces? (1)
- 3.1.3 Briefly describe the term *exchange rate*. (2)

- 3.1.4 What is the significant of the balance on current account? (2)
- 3.1.5 What impact will the increase in the value of the rand against the dollar have on trade? (8)
- 3.2 Differentiate between *Appreciation* and *Revaluation*. (8)
- 3.3 Evaluate the effect of currency depreciation in an economy. (8)

ACTIVITY 4

Study the graph below and answer the question that follows



- 4.1.1 Name the exchange rate system represented by the graph above? (1)
- 4.1.2 What is the original rand/Yuan exchange rate before supply for Chinese Yuan increase? (1)
- 4.1.3 Briefly describe the term appreciation. (2)
- 4.1.4 Briefly explain how the terms of trade will be affected by depreciation of the exchange rate? (2)
- 4.1.4 How can a surplus on the balance payment affect the South African economy positive. (4)
- 4.1 Discuss the climate conditions and labour resources as the supply reasons

for international trade. (8)

- 4.2. Assess how an increase in import prices and an increase in export prices will affect the South African economy. (8)

ACTIVITY 5

Study the table below and answer the questions that follow: Dollar to Rand forecast by day-January 2020

DATE	RATE
27/01/2020	14.4357
28/01/2020	14.2629
29/01/2020	14.2506
30/01/2020	14.3023
31/01/2020	14.3522

- 5.1.1 When was USA imports at its highest? (1)
- 5.1.2 What could cause the rand to depreciate on day 4? (1)
- 5.1.3 Describe the term *depreciation*. (2)
- 5.1.4 How can interest rates be used to influence exchange rates? (2)
- 5.1.5 Calculate how much will a South African tourist pay for the flight ticket valued at R 18 450.00 given \$1= R15.67. Show all calculations. (4)
- 5.2 Discuss import substitution and export promotion as measures to correct BOP disequilibrium. (8)
- 5.3 How can imports be targeted to reduce the deficit on the BOP? (8)

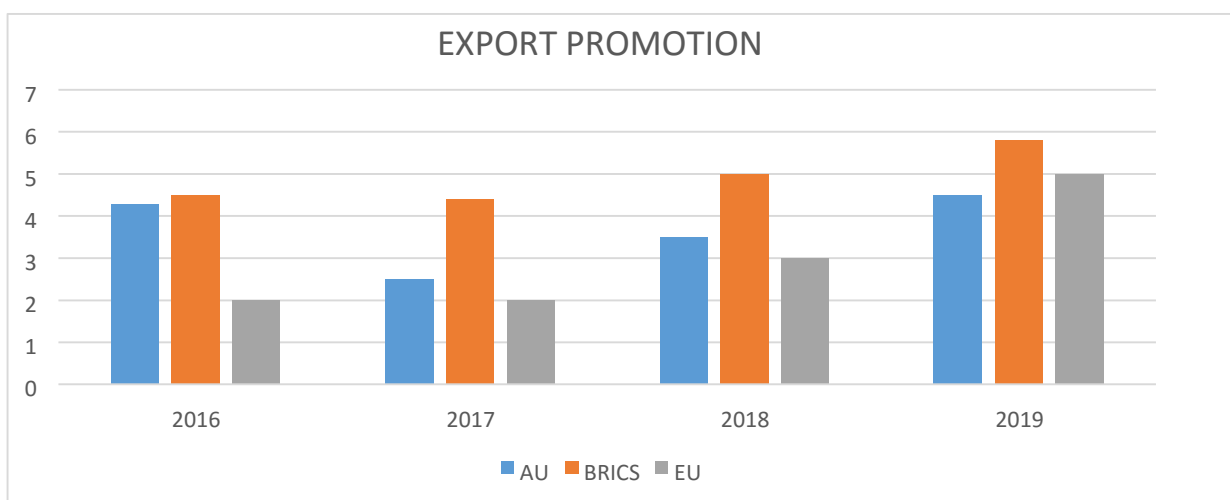
Key Concepts

BRICS	An association of emerging economies consisting of Brazil, Russia, India, China
disinvestment	Withdrawal of capital investment from a company or country
embargo	An official state ban on trade or other activities with a particular country
export promotion	An Incentives to encourage the production of goods that can be exported. It is part of
Free trade	When producers and consumers are free to buy goods and services from anywhere
import substitution	Goods that were previously imported are replaced with locally produced goods. It is part of South Africa's international trade policy
Mercosur	Mercosur An organisation to promote free trade amongst Argentina, Brazil, Paraguay and Uruguay



Activity 1

1.1 Study the graph below and answer the questions that follow:



- 1.1.1 Identify the year in which South Africa exported more goods to BRICS nations. (1)
- 1.1.2 Name one country besides South Africa that is a member of BRICS. (1)
- 1.1.3 Briefly describe the term export promotion (2)

- 1.1.4 What impact does globalisation have on exports in South Africa? (2)
- 1.1.5 How can the South African government promote exports? (4)
- 1.2 Discuss dumping as an argument in favor of protectionism. (8)

Activity 2

- 2.1 Study the illustration below and answer the questions that follow:



- 2.1.1 Name the trade policy associated with the above logo. (1)
- 2.1.2 Name the department that advocate for the proudly South Africa campaign. (1)
- 2.1.3 Briefly describe the term import substitution. (2)
- 2.1.4 How does import substitution contribute to a positive balance of payment? (2)
- 2.1.5 How can diverting trade be used to promote import substitution? (4)

Activity 3

- 3.1 Study the extract below and answer the questions that follow:

South African president on the citrus trade between SA and the USA.

For almost a year now, the South African citrus industry has been impatiently waiting for the US to publish a new rule which would grant further access for their fruit to the American market. Although South Africa is not part of the war between the two superpowers, obtaining further access is seen as vital for the South African citrus industry in its efforts to successfully market its fast increasing production in future. What will be of concern for the South African citrus sector is that the US may well punish South Africa for its stance on Huawei? At stake is South Africa's participation in the AGOA agreement, which gives African produce duty free access to the US. At present South Africa exports around 50,000 pallets of citrus to the US annually. The expanded access will mean that more areas of the country will be able to ship to the US and benefit from AGOA

(Source: Sunday times, 14 December 2019)

- 3.1.1 Write the abbreviation AGOA in full (1)
- 3.1.2 Name the international institution that enabled the formation of AGOA (1)
- 3.1.3 Briefly describe the term trade liberalisation. (2)
- 3.1.4 How will South Africa benefit if the USA publishes a new rule which would grant further access for their fruit to the American market. (2)
- 3.1.5 How does free trade affect developing countries negatively? (4)
- 3.2 Argue how free trade rather than protectionism will favour countries (8)

Activity 4

- 4.1 Study the illustration below and answer the questions that follow:



- 4.1.1 Name one method of promoting protectionism (1)
- 4.1.2 Name the organisation that was replaced by the WTO IN 1994. (1)
- 4.1.3 Briefly describe the term dumping (2)
- 4.1.4 Why would protectionism cost jobs? (2)
- 4.1.5 How is South Africa benefiting from free trade? (4)
- 4.2 What can be regarded as the correct (mix between free trade and protectionism)? (8)

Essay Questions

- 4.3 South Africa's international trade policy consists of export promotion and import substitution. Discuss export promotion in detail as part of South Africa's foreign trade policy. (26)
- Explain how successful South Africa is in protecting the local textile industry against foreign competition. (10)
- 4.4 South Africa's international trade policy consists of export promotion and import substitution. Discuss import substitution in detail as part of the South African international trade policy. (26)
- How can a policy of free trade benefit South Africa? (10)

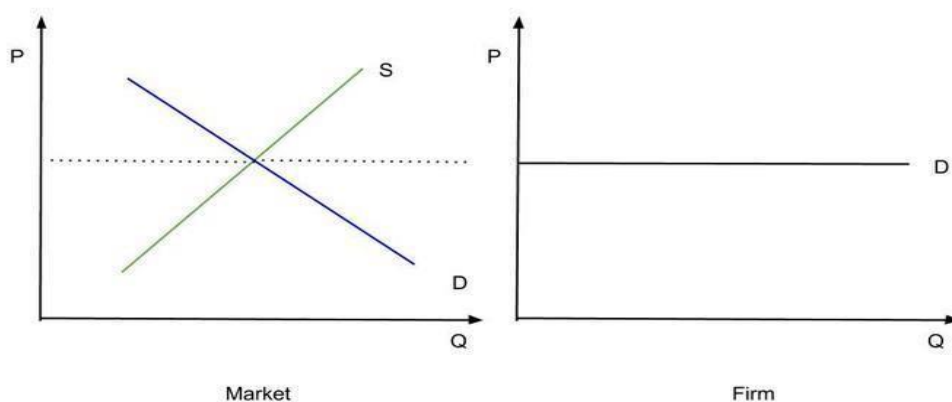
Key Concepts

Term	Definition
Economic loss	When total costs are greater than total revenue. When average revenue is lower than average cost the firm makes an economic loss
Economic profit	Profit that is made in addition to normal profit. When average revenue is greater than average cost the firm makes an economic profit
Explicit cost	Actual expenditure of business, e.g. wages and interest
Implicit cost	Value of inputs owned by entrepreneur and used in the production process (forfeited rental, interest + salary)
Long run	The period of production where all factors can change. The time is long enough for variable and fixed factors to change
Market	An institution or mechanism that brings together buyers and sellers of goods or services
Market structure	How a market is organised
Monopolistic competition	A market structure in which businesses have many competitors, but each one sells a slightly different product (e.g. CD's and books)
Monopoly	Exclusive control of a commodity or service in a particular market
Normal profit	The minimum earnings required to prevent an entrepreneur from leaving the industry. When average revenue equals average cost the firm makes a normal profit
Oligopoly	A market structure controlled by a small group of businesses
Perfect competition	A market structure with large numbers of producers and buyers
Price taker	Has no influence on price. Takes price that is determined by the market
Short run	The period of production where only the variable factors of production can change while at least one factor is fixed
Shut-down point	Business will close where $MC = AVC$
The Competition Appeal Court	An institution whose main functions is to review orders made by the Competition Tribunal and amend or confirm these orders
The Competition Commission	An institute that investigates restrictive business practices, abuse of dominant positions and mergers in order to achieve equity in the South African economy
The Competition Tribunal	An institution whose main function is to approve large mergers, adjudicate in the case of misconduct and issue orders on matters presented to it by the Competition Commission

Total Product/Output	Total product is the maximum output that the firm can produce with the given number of fixed and variable inputs at its disposal	
Marginal Product/Output	Marginal product is the additional unit of output which is produced as one more unit of the variable input (labour) is combined with the fixed input	$MP = \frac{\Delta TP}{\Delta Q}$
Average Product/Output	Average product of a variable input shows the contribution that each labourer makes towards production	$AP = \frac{P}{Q}$
Fixed Costs (indirect costs/overhead costs)	Costs that remain the same even if the output changes. Examples are rent, depreciation, insurance	
Variable Costs (direct costs/prime costs)	Costs that change according to changes in output. E.g. wages the cost of raw materials, electricity etc.	
Total cost	The cost/remuneration for all the factors of production used in the production process	$TC = FC + VC$
Marginal costs	Marginal cost is the amount by which total cost increases when one extra product is produced	$MC = \frac{\Delta TC}{\Delta Q}$
Average cost	Average cost is the cost per unit of production	$AC = AFC + AVC$ or $\frac{TC}{Q}$
Average fixed cost	To calculate average fixed costs, we divide fixed costs by the amount of goods produced	$AFC = \frac{FC}{Q}$
Average variable cost	To calculate average variable costs, we divide variable costs by the amount of goods produced	$AVC = \frac{VC}{Q}$
Total Revenue	Total revenue is the total income received from the sale of goods or services	$TR = P \times Q$
Marginal revenue	Marginal revenue refers to the extra amount of income gained by selling one more unit of production	$MR = \frac{\Delta TR}{\Delta Q}$
Average revenue	Average revenue refers to the amount a firm earns for every unit sold	$AR = \frac{TR}{Q}$

Perfect Market.

Perfect competition is the structure in which there are many firms producing homogenous products. None of the firms could be large enough to influence the market. Prices are determined by the market (demand and supply). The point where demand and supply meet is called equilibrium point. Firms take the price that is determined by the market, they do not have influence of price. The demand curve of the firm is horizontal because they cannot change the price. The horizontal demand curve represents the $D=P=AR=MR$. This demand curve is perfectly elastic, meaning that a slight increase in the price the quantity demanded will drop to zero.



DETERMINATION OF OUTPUT IN THE PERFECT MARKET

IN THE SHORT TERM

The **equilibrium price** in Fig 1 is P_1 where demand and supply intersect. The individual producer in Fig 2 can sell any quantity at this price. He takes the price that has been determined in the market. He has no reason to reduce the price to P_0 because buyers are prepared to pay P_1 . If he reduces the price, he will soon run out of stock. He will be forced to increase the price back to P_1 . If he sells at P_2 he will have no buyers. Consumers will buy from other sellers because there are many other sellers in the market. He will be forced to reduce the price back to P_1 .

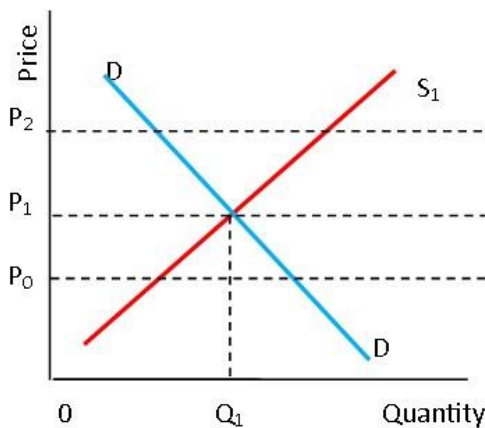


Fig 1: The market

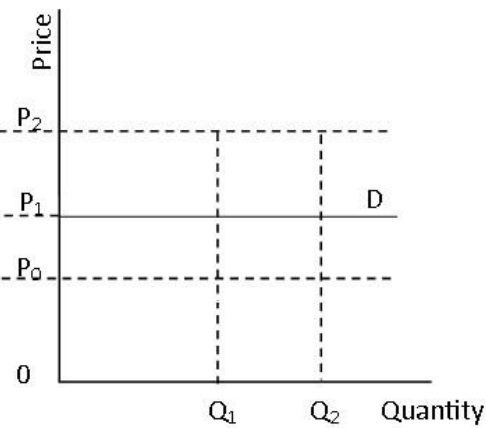


Fig 2: The individual firm

What is marginal revenue?

Marginal revenue (MR) is the additional revenue the producer gets by producing one more unit. The individual producer must produce at a point where marginal revenue is **equal** to marginal cost ($MR=MC$). The profit maximizing point in Fig 3 is A. In a perfect market the price (P) is the same as MR and the demand (D). In Fig 3 both MR and D coincide in one curve.

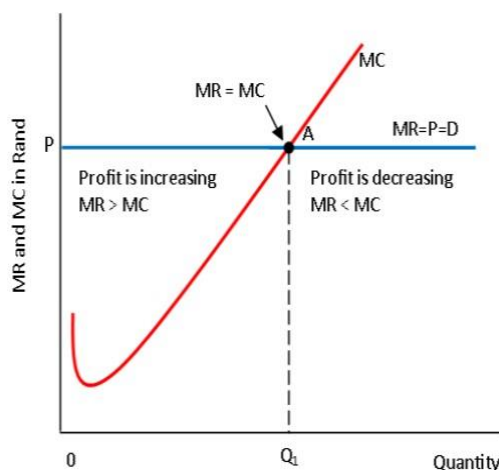
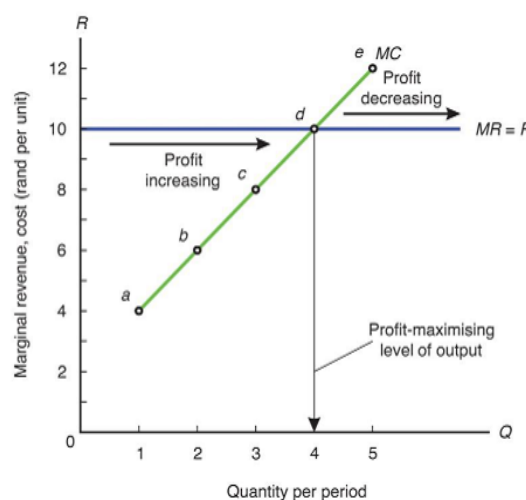


Fig 3: Profit maximisation

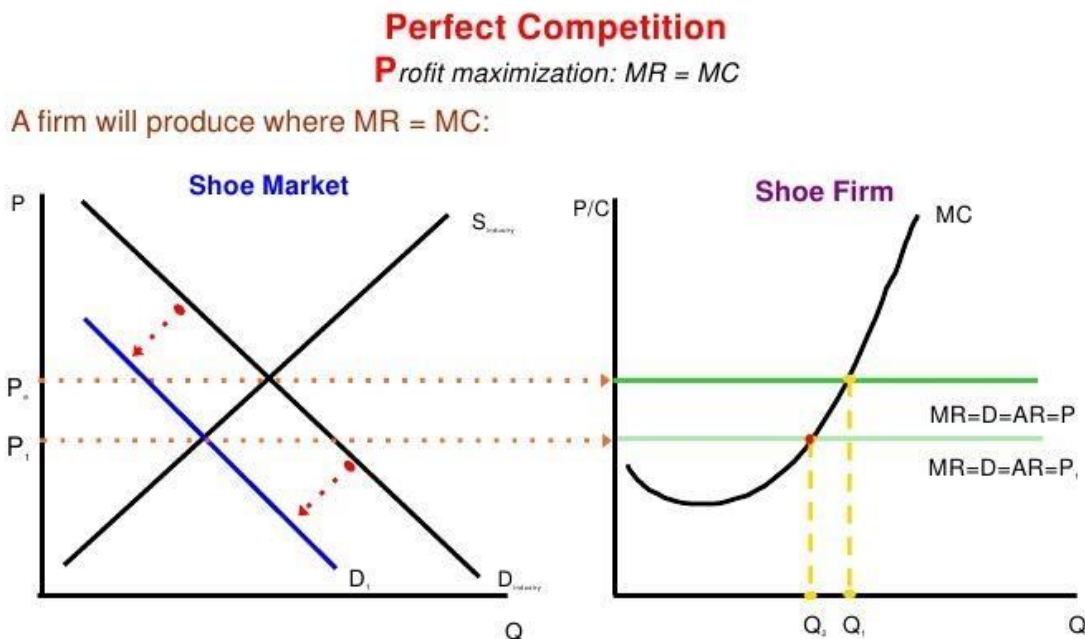


In Fig 3 if the firm is producing a quantity between 0 and Q_1 it is worthwhile to continue producing because at this stage more profits can be obtained by producing more. At this stage MR lies above MC. The profit-

maximising rule says as long as MR is more than MC the firm must continue to produce until $MR = MC$. The maximum profit is obtained at point A where $MR = MC$. At any point to the left of A, the firm must increase its output in order to increase profit. At any point beyond A, MC lies above MR – the cost of producing one more unit is more than the revenue obtained. A wise entrepreneur will not produce beyond A because that will reduce his profit. Point A is called the **profit maximising point*** because that is where the profit is at its maximum.

How much must be produced and sold at this price? Firms use marginal revenue-marginal cost rule

Marginal Revenue and Marginal Cost of a firm operating in a perfectly competitive market



The profit-maximizing level of output by the firm depends on the price determined by the market

- 1) P_e is determined by the total market supply and demand.
- 2) The firm faces its own marginal cost curve
- 3) The firm will choose to produce at the level of output where the MC equals MR
- 4) If MR falls because of falling demand, profit maximizing level of output for the firm falls

IN THE LONG-TERM

Production level in the long-run is determined using the long-run average cost (LAC) curve. LAC is a summation of short-term costs, SACs. LAC is U-shaped. This shows that long-run costs decrease in the beginning as the size of the firm increases. This happens because when the firm begins to buy in bulk, it gets discounts and the average input costs decrease.

In the long-run all factors of production are variable. The firm can increase its size or it can acquire more factors of production. As the business becomes bigger, its costs of production per unit become lesser. We say in the long-term the firm enjoys the **economies of scale***. This is depicted by the falling part of the LAC curve in Fig 4 – the area between A and B.

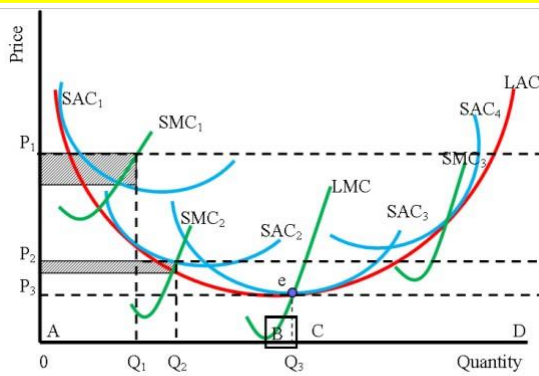


Fig 4: Long-term production level of the firm

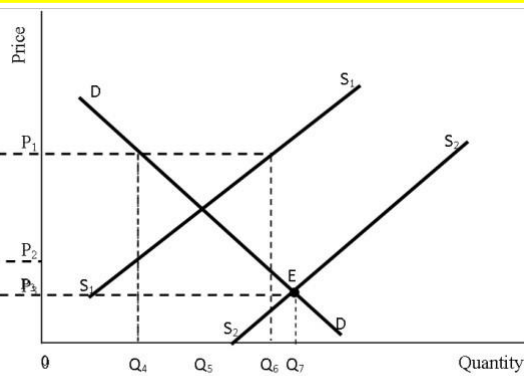


Fig 5: Long-term production level of the industry

The curves SAC₁ to SAC₄ are the short-term average cost curves of the same firm. The curves SMC₁ to SMC₃ represent the short-term marginal cost curves of the same firm. At a price of P₁ the firm is producing Q₁ and making economic profit (shaded area). As time goes on the firm is able to increase its size. As the size increases, the average costs are decreasing – shown by the lower SAC₂. During this stage the firm is able to buy more inputs at a lower cost because of bulk-buying. As long as LAC is decreasing, the firm must continue to increase its size because it will make more profiting by doing so.

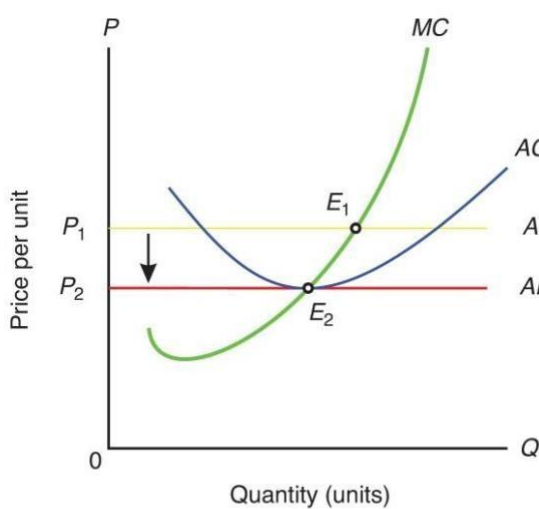
The optimum point of production level in the long term is “e” where output is Q₃.

Here LAC is at its minimum point. LMC cuts LAC at its minimum point. As long as the firm is producing any quantity to the left of Q₃ it can increase its profit by producing more. The firm must take advantage of the economies of scale applicable to this stage.

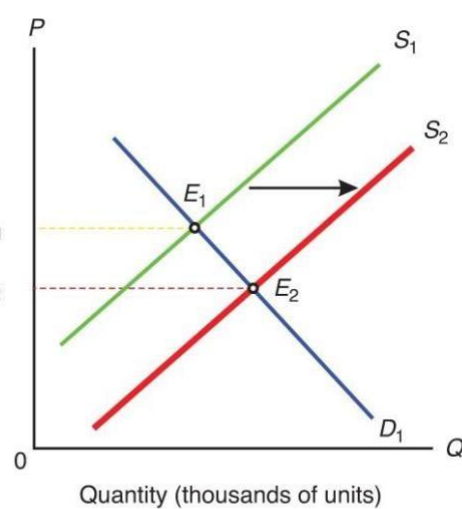
However, the firm must **not exceed** point “e”. At any production level beyond “e” the firm will suffer the **diseconomies of scale*** because it will become too big and cumbersome.

The individual firm and the industry when the firm initially earns an economic profit

•If firms are making an economic profit – new firms enter the market



(a) The firm

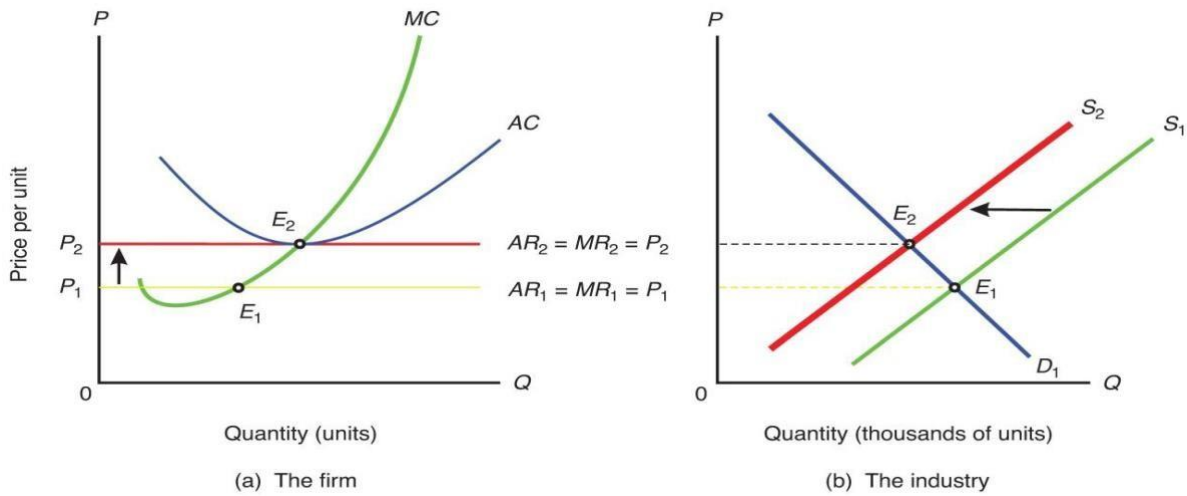


(b) The industry

In the long run, economic profit cannot be sustained. The arrival of new firms in the market causes the demand curve of each firm to shift downward, bringing down the price, the average revenue and marginal revenue curve

in the long run the firm will make zero economic profit. Its horizontal demand curve will touch its average total cost curve at its lowest point.

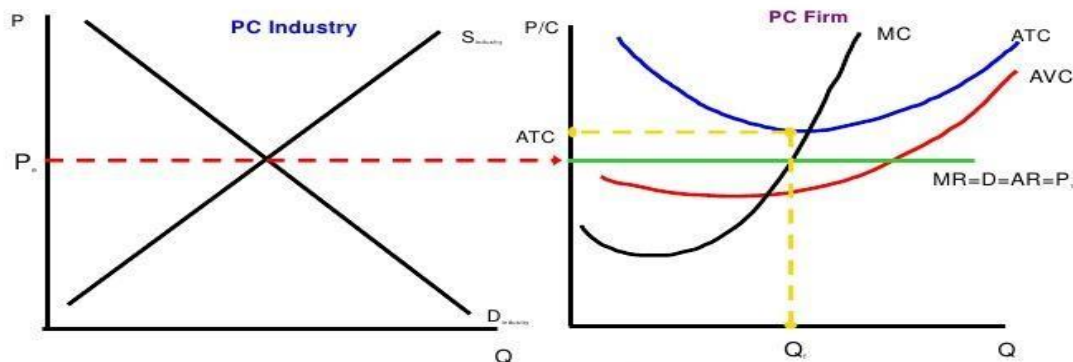
The individual firm and the industry when the firm initially makes an economic loss • If firms are making an economic loss – existing firms exit the market



Perfect Competition

Profit maximization: $MR = MC$

Loss-minimizing case:



If the firm's costs increase or the price it can sell for decreases, it may be in a situation where it must minimize losses.

- $ATC > AR$, the firm is losing money on each unit it produces.
- The AR is still greater than AVC, meaning the firm can cover its variable costs in the short-run
- The firm will remain open as long as it can cover its variable costs

AR - ATC is negative, meaning the firm is experiencing losses

Determination of the output of the industry

Fig 5 shows the long term production level for the industry. Equilibrium in the industry is achieved where the quantity demanded is equal to the quantity supplied. The existence of economic profit in the industry attracts other firms. At P_1 the industry is prepared to sell Q_6 . As more firms enter the market, the supply increases to S_2 and the price drops to P_3 . The economic profit that was made in Fig 4 has decreased. Both the individual firm and the industry are making normal profit at P_3 . The individual firm produces Q_3 while the industry produces Q_6 . Q_6 is a sum total of all the quantities supplied by the individual firms that make up the industry. In the longrun all

businesses will produce output where they are making normal profit. Those businesses that make losses will exit the market.



DETERMINATION OF PROFITS IN THE PERFECT COMPETITION

Profit is a positive difference between TR and TC. There are two kinds of profits that the business can make economic profit and the normal profit.

1. ECONOMIC PROFIT

It is possible for an individual in the perfect market to make an economic profit in the short-term. There are two ways of determining economic profit – the total revenue/total cost approach and the marginal revenue: marginal cost approach.

a) **Total Revenue/Total Cost Approach**

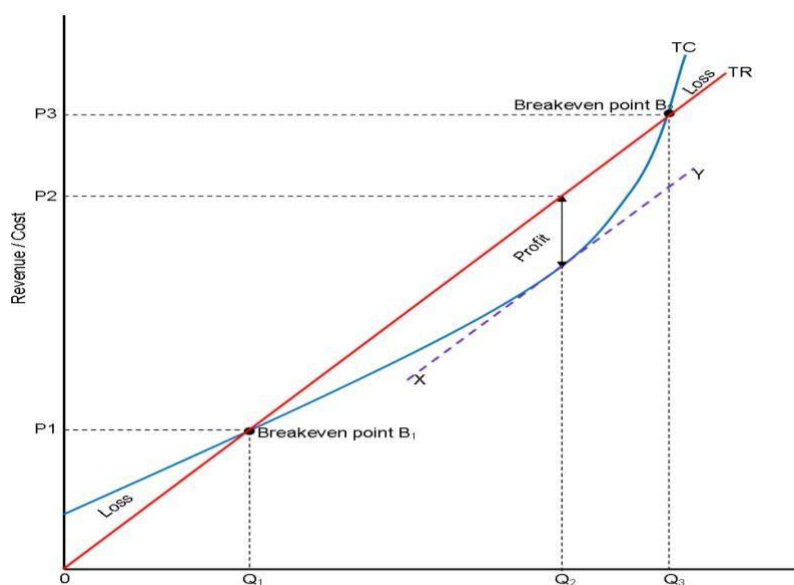


Fig 6 Total revenue : Total cost approach

The total revenue curve (TR) is drawn from the origin. Total cost (TC) starts above the origin because before production takes place there are fixed costs that are incurred. Between the output 0 and Q_1 , the firm is making a loss. TC runs above TR meaning the costs are more than revenue. However, the firm must continue producing because it can still make profit by producing more. If it continues to produce it will reach a breakeven point where TR is equal to TC (breakeven point B_1). At this point the firm is making a zero profit (zero loss). The firm is now able to cover its costs. It must continue to produce in order to realise a profit. Between Q_1 and Q_3 it is making economic profit. It will earn the maximum profit where the difference between TR and TC is the greatest. This will be at Q_2 . The maximum profit is found where the line XY (which is parallel to the TR curve) is tangent to TC. Again as the firm continues to grow, TC starts to increase until it reaches breakeven point B_2 . The firm should not grow more than point B_2 because it will make a loss.

b) The MR/MC approach

According to the MR/MC rule maximum profit is made at point where $MR=MC$. In Fig 7 below, that point is point A. At this point the total cost is $0CBQ_1$. Total revenue is $0PAQ_1$. The difference between TR and TC is CPAB. This is the economic profit that this firm is making. If the firm is producing a quantity which is less than Q_1 , it must continue to produce because it will still make more profit by doing so. For quantities to the left of Q_1 MR runs above MC. The firm must continue to produce until it reaches Q_1 . The profit maximisation point is a point where $MR = MC$ (point A in Fig 7).

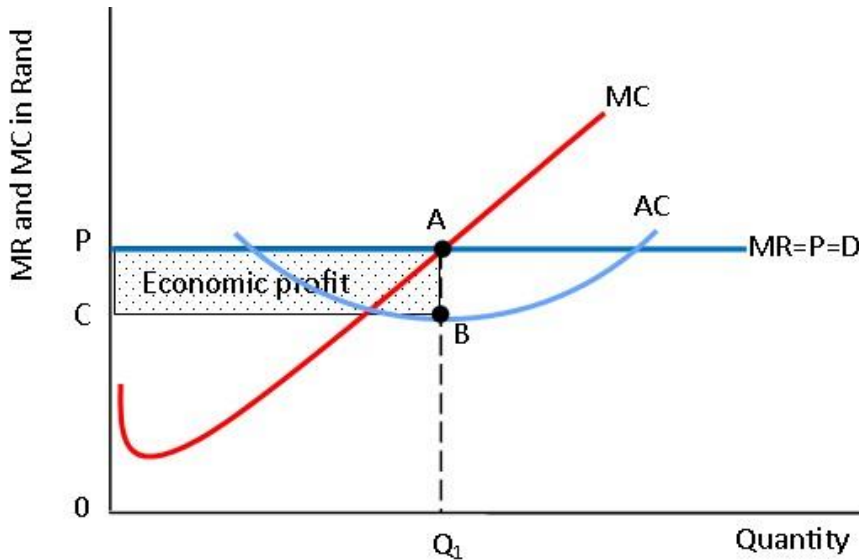


Fig 7: Economic profit



2. NORMAL PROFIT.

Because in the perfect competition there is free entry, more sellers will be attracted by the economic profit. As more firms enter the market economic profit is depleted. In the long-run only normal profit is made. Point E in Fig 8 shows normal profit in the long-run.

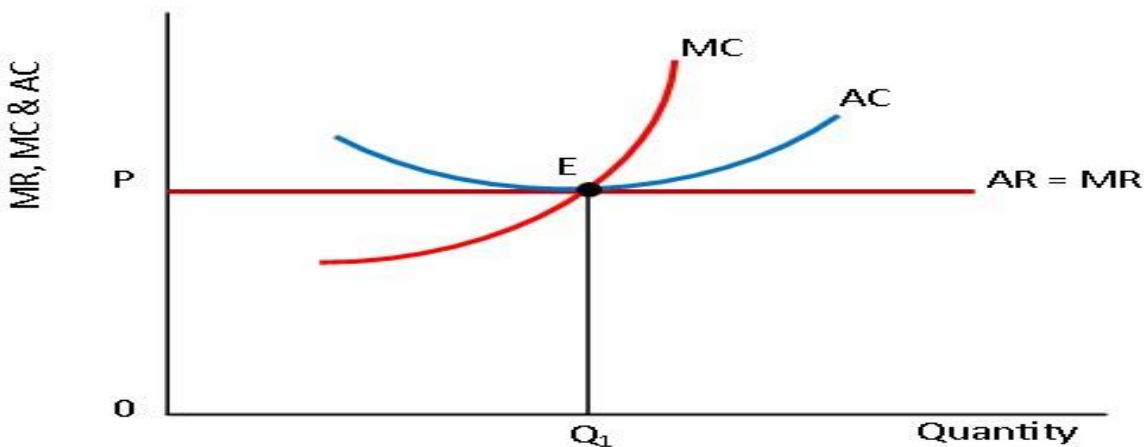


Fig 8 Normal profit

3. ECONOMIC LOSS

If the firm is making a loss, it will try to minimise its loss. The point where the loss is at it's a lowest is where $MR=MC$. Fig 9 shows economic loss in the short-run.

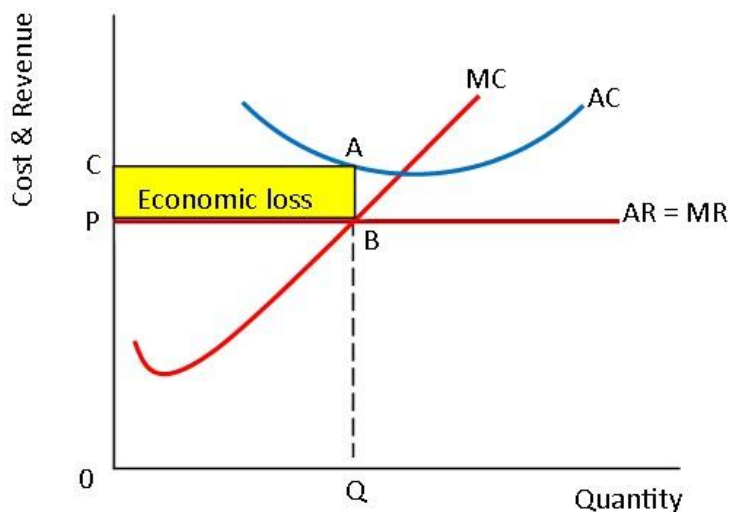


Fig 9: Economic loss

Economic loss is minimised at Point B where $MR=MC$. At a price of P the AC lies above the AR curve. The cost of producing one unit is more than the revenue received from that unit. In other words MC is more than MR. Total cost is $0CAQ$. Total revenue is $0PBQ$. Total cost is more than total revenue. The area CABP marks the economic loss.



The supply curve and the shutdown point

If the firm is making a loss when should it shut down? It should shut down at a point where average variable costs (AVC) are more than marginal revenue (MR). Remember, MR is the same as the price. It does not make sense to produce at a cost that is more than revenue. At that point the firm must shut down. That point is represented by A in Fig 10. If the price falls below P, the firm must shut down. Point A is called a **shutdown point**.

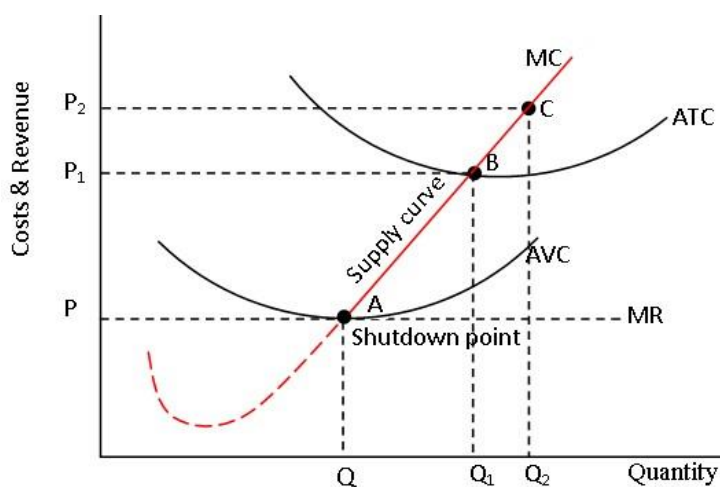


Fig 10: Shutdown point & supply curve

However, if the price is anywhere between P and P_1 , the firm can continue to produce because the price is above AVC . For the prices above P the firm is prepared to offer Q , Q_1 and Q_2 for sale. In other words points A , B and C form the supply curve of this firm. The supply curve is the rising part of the MC curve above the AVC .

1. MONOPOLY

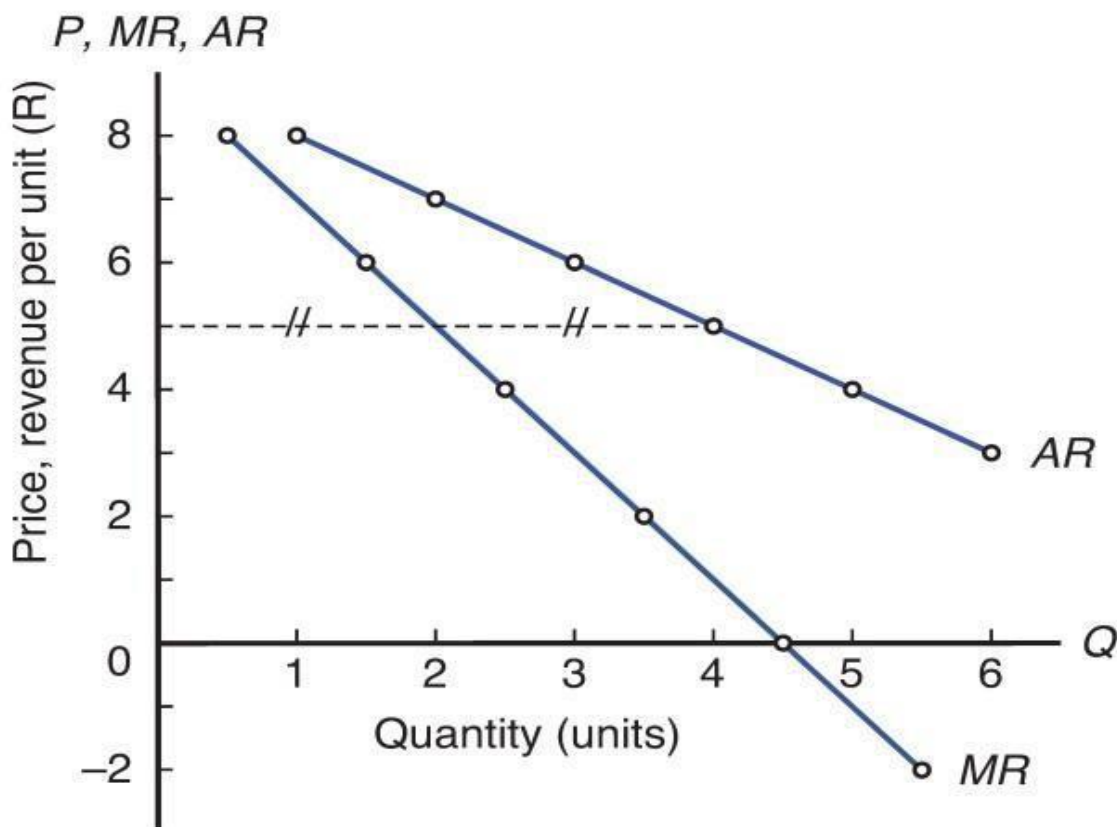
Term	Definition
Artificial monopoly	The barriers to entry are not economic in nature, but are caused by other factors. For example, a patent – this is the legal right of a holder to exclusively manufacture a product
Cartel	A group of producers whose goal is to form a collective monopoly in order to fix prices and limit supply and competition
Collusion	An arrangement between businesses with the aim of limiting competition between them by fixing prices
Imperfect market	When the market price is not a pure reflection of the scarcity (lack) of that product
Legal monopoly	Monopoly based on laws preventing other companies from competing
Monopolistic competition	A market structure with many buyers and sellers where entry is relatively easy but the product is differentiated, e.g. toothpaste
Monopoly	A market structure where only one seller (producer) operates. Entry is blocked and the product has no close substitutes
Natural monopoly	High development costs prevent others from entering the market. A single business can serve the whole market at a lower price due to economies of scale, being large e.g. water and electricity
Non-homogenous	Manufacture different variations of their products in order to make it difficult for other companies to copy that specific product
Oligopoly	A market structure where only a few sellers operate. Entry is difficult and products can be differentiated or standardised
Price leadership	A situation where one firm fixes a price and the others accept it as the market price

Imperfect markets

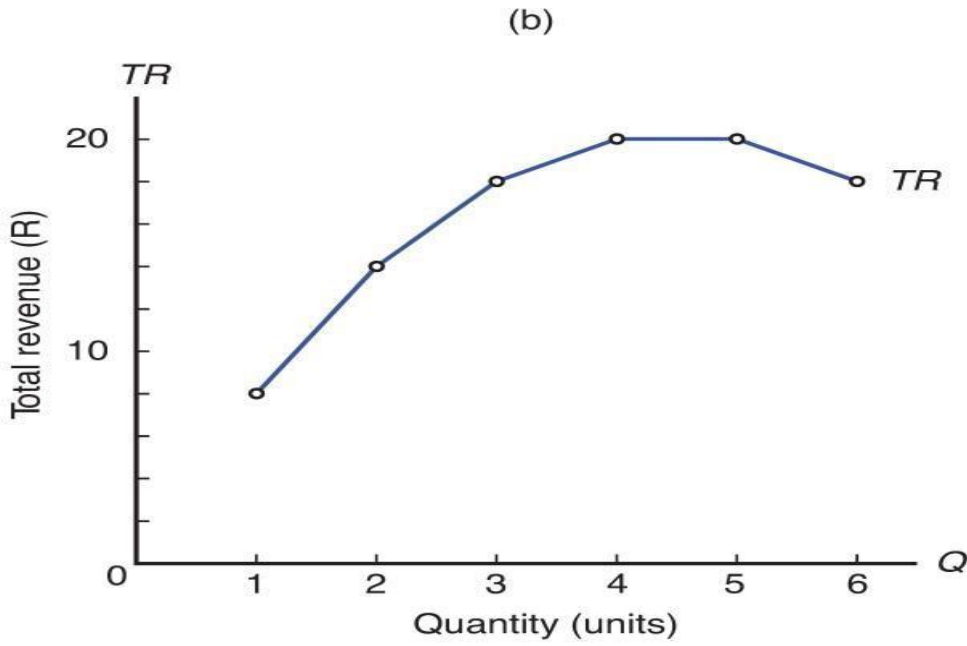
An imperfect market refers to any economic market that does not meet all the characteristics of a perfectly competitive market. An imperfect market arises whenever individual buyers and sellers can influence prices and production, or otherwise when perfect information is not known to all market actors.

AR and MR under monopoly

(a)



TR under monopoly

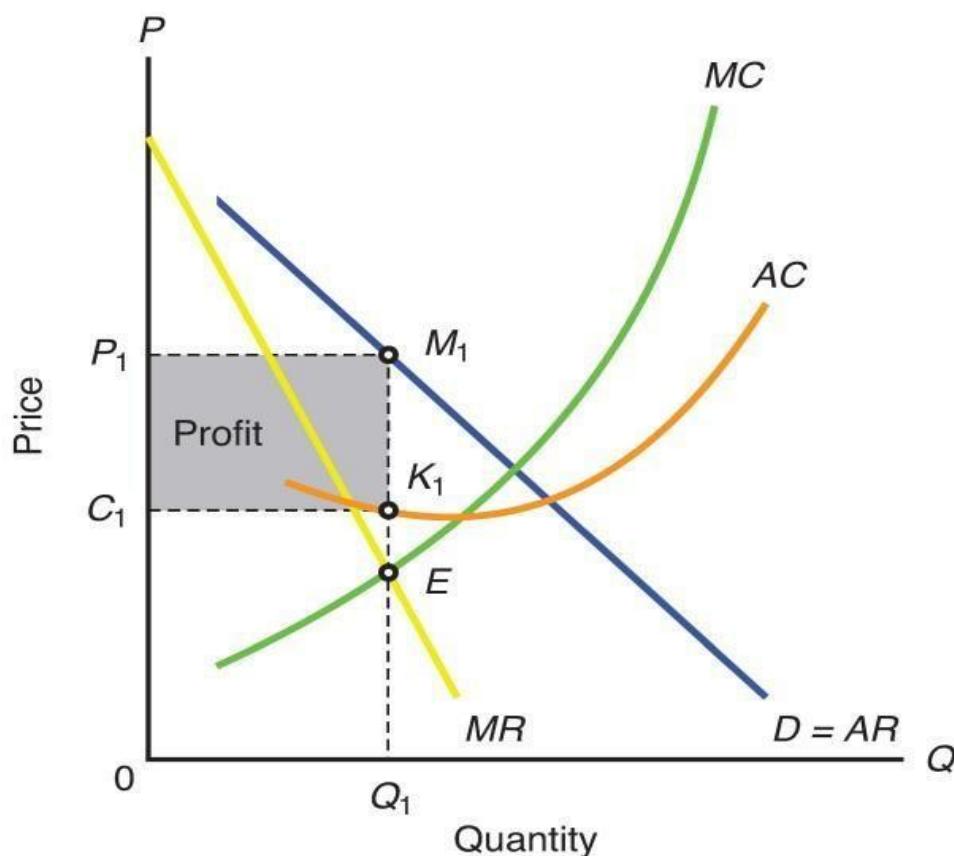


Profit-maximising or equilibrium position in the short-run

- Monopolies follow the same profit maximizing rule as competitive firm, $MR=MC$.
- The downward sloping demand curve indicates that monopolist can increase its quantity when it lowers the price of the product.
- The demand curve of a monopoly is also the AR curve.
- The MR is always below the AR under monopoly.



The short-run equilibrium of the firm under monopoly



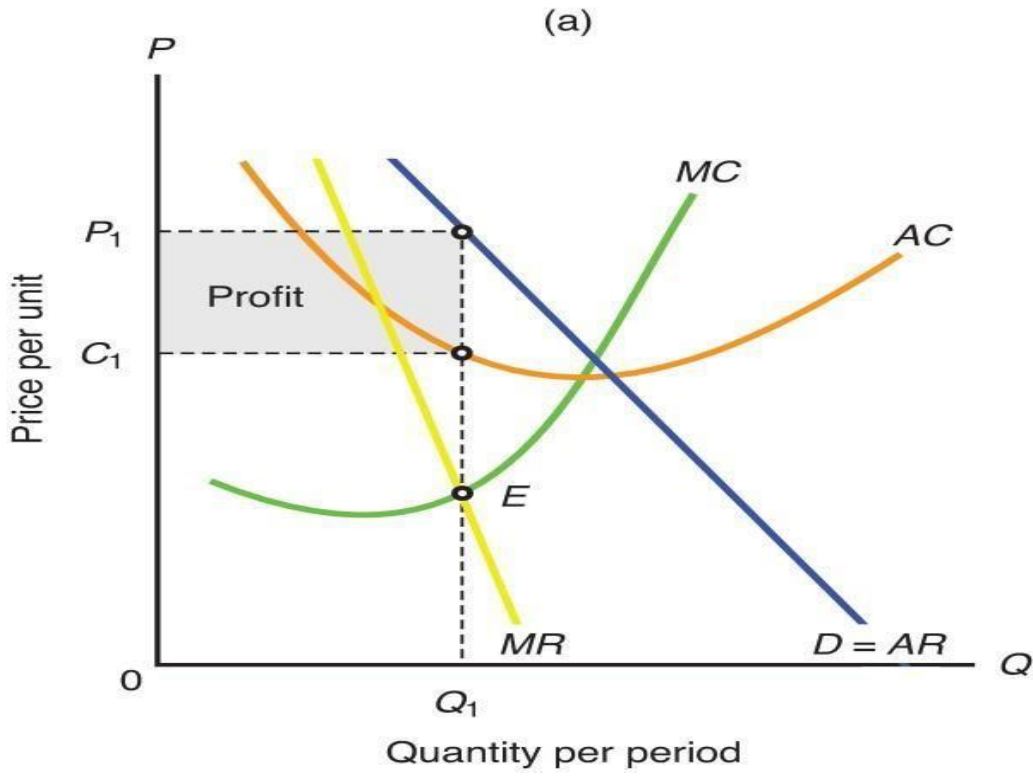
In the Long Run, economic profits can be maintained!!

The short-run equilibrium of the firm under monopoly Economic Profit

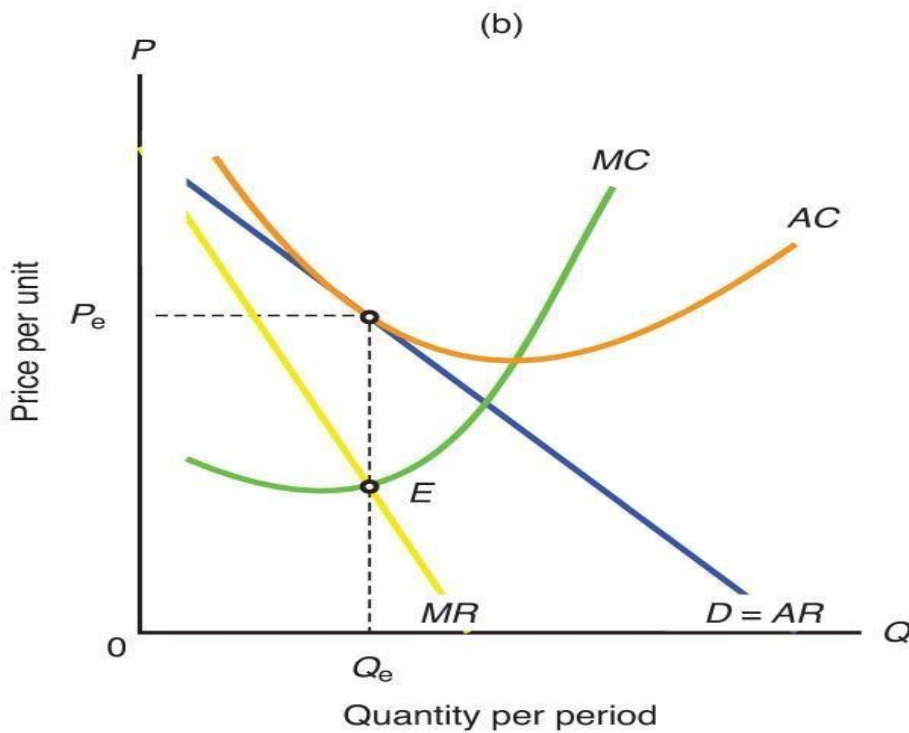
The monopolist will produce at Q_1 where $MR=MC$.

- The monopolist will charge price P_1 , which is determined by the demand curve.
- Is the monopolist making an economic profit or loss?
- We compare the AR and AC to determine whether the monopolist makes a profit or loss.
- $AR (=P) > AC$, therefore the monopolist is experiencing economic profit.
- NB in the long-run due to barriers to entry of firms, monopolist may also make economic profit.

Short Run Equilibrium of Monopolistic Competition



Long Run Equilibrium of Monopolistic Competition



1.1 PROFIT IN THE SHORT-RUN

Let's look at the determination of profit and loss in the short-term. The dynamics that face the monopolist are not the same as those that face a firm in the perfect competition. While the individual firm in a perfect competition is the pricetaker, the monopolist is the **price-maker***. While the individual firm in a perfect competition is faced with a horizontal demand curve, the monopolist is faced with a downward-sloping demand curve. This means the firm in the perfect competition can sell any quantity at the market price. The monopolist, on the other hand, can reduce his price up to a point where he makes maximum revenue. The point where the maximum profit is made is determined where **MR = MC**.

The monopolist is faced with the same cost structure as any other business. To maximise profit the monopolist must produce at a point where $MR = MC$. Suppose Table 1 shows the marginal revenue and marginal cost of a certain monopolistic business.

Table 1 Profit maximisation schedule of a monopolist

Quantity	Price	Marginal revenue	Marginal cost
0	110	-	-
1	R100	R100	R40
2	R90	R80	R20
3	R80	R60	R30
4	R70	R40	R40
5	R60	R20	R50
6	R50	R0	R60
7	R40	-R20	R70
8	R30	-R40	R80

MR and MC are going in opposite directions. As output increases marginal revenue decreases while marginal cost decreases. They are bound to meet somewhere. This happens at the output of 4 units. Both MR and MC are equal at R40 each. This is the profit maximising point. At the quantities smaller than four, marginal revenue is bigger than marginal cost. At the fourth unit $MR = MC$. At quantities bigger than four, MR falls below MC. This confirms that the point where the monopolist makes the maximum profit is where MR and MC are equal.

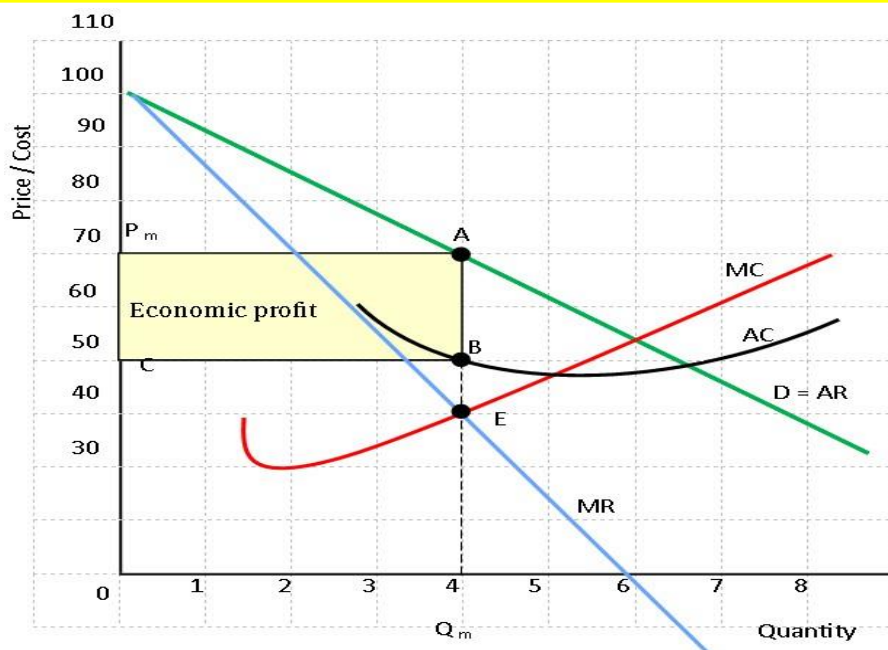


Fig 1: Profit maximisation by the monopolist

Fig 1 is a graphical representation of Table 1. Marginal revenue and marginal cost are measured on the y axis while the quantity is on the x axis. The profit maximisation point is Point E where MR and MC are equal. The corresponding output produced is 4 units (Q_m – monopoly quantity). On quantities smaller than Q_m , the MR curve runs above MC curve. This is to show that the monopolist can still increase his profit by increasing output until the point where $MR = MC$. In the graph above that happens when four units are produced. He cannot produce more than four units because the fifth unit and more are produced at a higher cost. From the fifth unit upwards, marginal cost is more than marginal revenue – MC is now above MR.

To determine the price the monopolist will charge, we extend the vertical line from Q_m right up to Point A where it meets with the demand curve. The price that corresponds to Q_m on the demand curve is R70 (P_m – monopoly price). The average cost (AC) is the total cost of production. The cost of producing four units is R50 each. It is found where AC cuts the Q_mA line at point B. There are **two methods** of calculating profit.

1. **Using the totals:** Total revenue *minus* total cost. Total revenue is the area marked $0P_mAQ_m$ which is $R70 \times 4 = R280$. Total cost is the area $0CBQ_m$ which is $R50 \times 4 = R200$. Therefore profit is $R280 - R200 = R80$.
2. **Using unit values:** (Profit per unit *minus* cost per unit) \times quantity $(R70 - R50) \times 4 = R80$

In both cases the monopolist is making an economic profit. Economic profit is the profit that is over and above the normal profit. It is also called the **abnormal, supernatural** profit.

1.2 ECONOMIC LOSS

Does the monopolist always make economic profit? It is possible for the monopolist to make a loss as well. The monopolist makes a loss if total cost (AC) is more than average revenue (AR). Remember, AR is the price at which the product is selling. Now, if the cost is more than revenue, the company will make a loss.

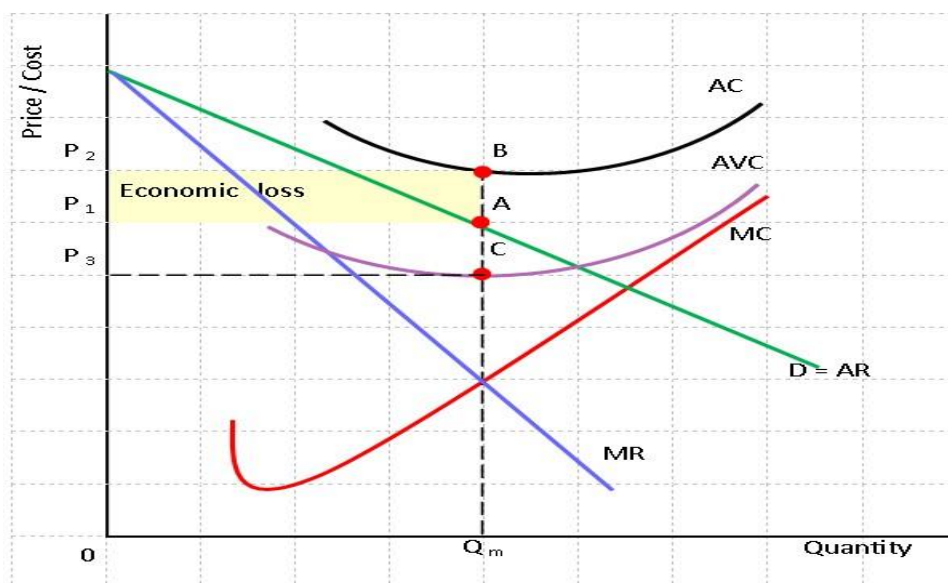


Fig 3 Economic loss

The MR/MC rule applies even where the company is making a loss. Fig 3 shows AC running above the average revenue curve (AR). This tells us that the cost is more than the price. The company is making an **economic loss** here. The area $P_1 P_2 BA$, represent the economic loss that the firm is making. Note that AR is above AVC. Although the firm is making a loss, as long as average revenue (AR) is greater than average variable cost (AVC) in the short-term, the company can continue producing. At this stage the company can still cover its variable costs. There is no need to shut down the business yet. The monopolist should shut down when the price falls below AVC.



1.3 Determination of profit and loss in the long run

a) Long-run profit

A firm that is making economic profit in the short-run will try to sustain it even in the long-term. A firm that is making economic loss in the short term will try to improve its situation so that it can make economic profit in the long term.

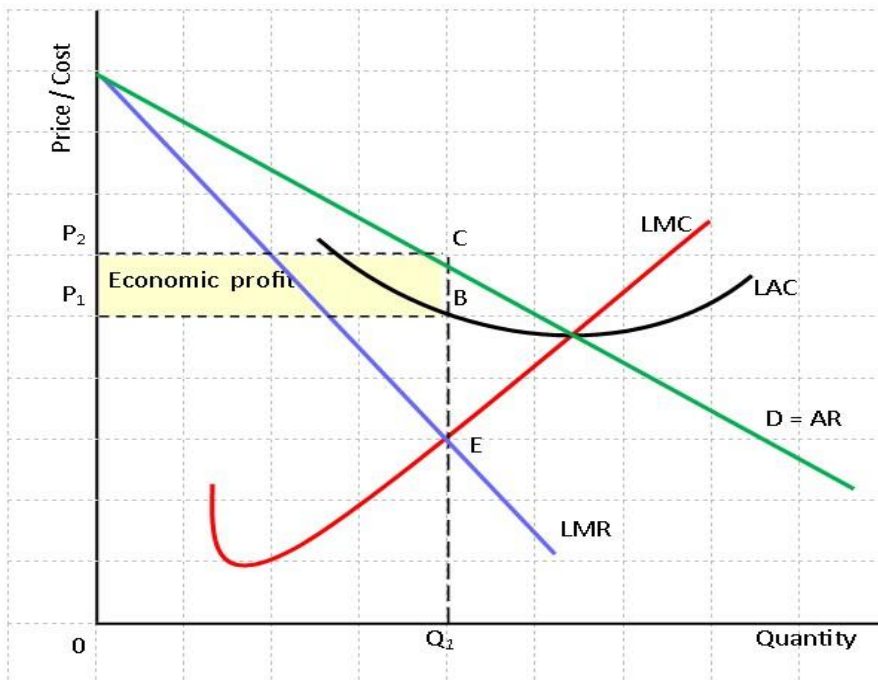


Fig 4 Long-run equilibrium of the monopoly

The monopolist makes economic profit even in the long term. Equilibrium in the long term is determined where $LMR = LMC$ at point E. The price the monopolist charges is obtained by extending the line to point C on the demand curve, $D=AR$. Total revenue is $0P_2CQ_1$ while total cost is $0P_1BQ_1$. Economic profit is the difference between $0P_2CQ_1$ and $0P_1BQ_1$ which is P_1P_2CB .



1.4 Comparison between monopoly and perfect competition

	Perfect competition	Monopoly
Demand curve	The individual firm in a perfect competition faces a perfectly elastic demand curve. He cannot change the price. If he tries to increase his profit by increasing the price, consumers will move away and buy from someone else. If he tries to increase sales by reducing the price, he will immediately run out of stock because he will be swamped by customers. The individual firm in a perfect competition is a price-taker . The price is determined in the marketplace by the interaction of demand and supply	The monopolist faces a downward-sloping demand curve. He knows his demand and can manipulate output in order to make maximum profit. Since the monopoly also forms the market on its own, the demand for an individual monopolist is the same as the demand for the industry. The monopolist can increase his profit by reducing the price up to a level where MR is equal to MC. This quantity is the profit-maximising quantity
Efficiency	Businesses in the perfect competition are forced to achieve both productive and allocative efficiencies. At point E in Fig 5(a) both productive and allocative efficiencies are achieved. Productive efficiency means production takes place at the lowest possible cost. This is achieved at point E because ATC is at its minimum point. Allocative efficiency is achieved because price is equal to marginal cost.	In Fig 5(b) the monopolist charges a price which is much higher than the price charged in the perfect competition. The monopolist charges P_2 instead of P_1 which is charged by perfect competition. The monopolist produces a lesser quantity than the perfect competition. The allocative efficient output is Q_{Com} which is the output associated with the minimum point of ATC. Instead the monopolist produces Q_M which is less than the output the society wants. The monopolist is only interested in making maximum profit for himself. He is looking for the point where $MR = MC$. As a result society loses the quantity $Q_M Q_C$.
Profit	The economic profit made in the perfect market is gradually reduced as more firms enter the market. In the long term the perfect competition makes a normal profit.	In the monopoly, the economic profit made is sustained indefinitely. The monopolist continues making economic profit both in the short run and the long run.

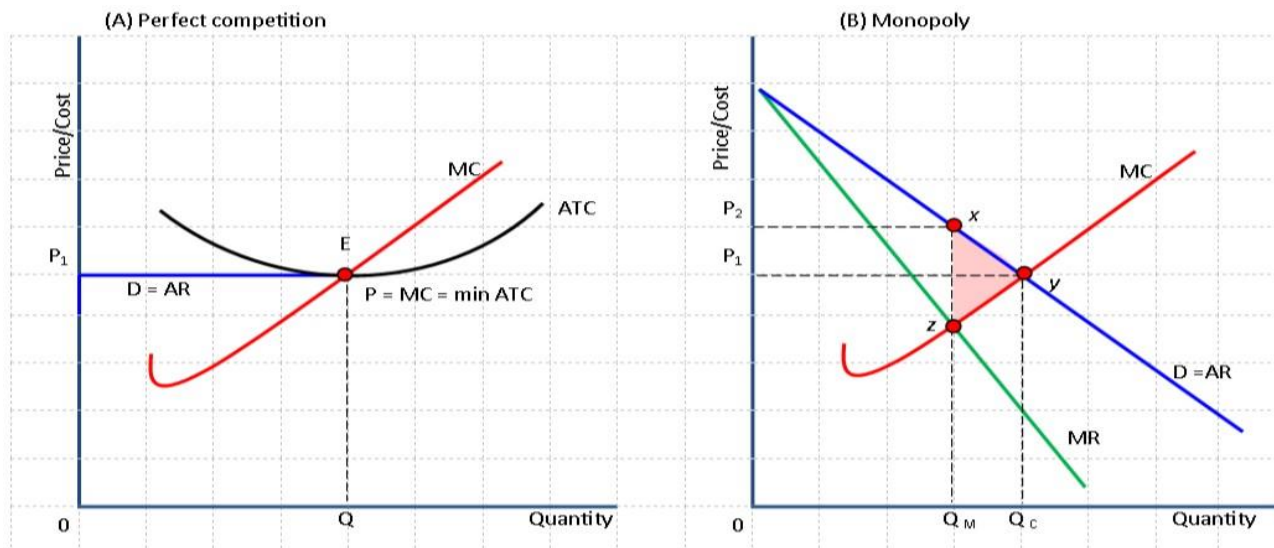


Fig 5 Inefficiency of monopoly compared against perfect competition



2 OLIGOPOLY

2.1 Characteristics of an oligopoly

Number of businesses	There are few but large businesses e.g. Vodacom, MTN, Cell C in the cellphone industry. The Big4-Banks of SA also form oligopoly. If there are only two firms it is called the duopoly . If the firms are more than two it is called the pure oligopoly . Entry is free but not easy.
Nature of the product	The product may be identical or differentiated e.g. cement or steel producers. If the product is homogeneous the market is a pure oligopoly . If the product is differentiated the market is called differentiated oligopoly . Examples of pure oligopoly are the producers of cement and steel. These are very few but big industries. Examples of differentiated oligopolies are manufacturers of toothpaste, banking services, insurance companies.
Freedom of entry & exit	There are strict barriers which prevent entry into the market. However, it is possible for many smaller firms to operate on the periphery of an oligopolistic market, but none of them is large enough to have any significant effect on market prices and output.
Decision making	There is a lot of interdependence between the different firms. The decisions taken by one firm are influenced by the decisions of other firms. Each firm is aware of the others' actions. If one firm introduces a new marketing strategy all the other competitors become aware and do the same. A new advertising campaign by one firm causes others to follow suit – refer Cell C's "Call for free on the weekends".

<p>Control over price</p>	<p>The oligopolist has control over the price but not as much as the monopoly. He is a price-maker. However, he must consider the reaction of other firms. The prices charged by oligopolists are closely related. Example interest rates charged by banks are very similar.</p> <p>The oligopoly is characterised by price rigidity. Prices tend to be rigid and sticky. If any firm cuts the price, the rival firms retaliate by cutting their prices as well. A price-cut by one competitor initiates a price-war in the oligopolistic market. Hence under oligopoly no firm resorts to price cutting without first consulting other firms in the market.</p>
<p>Non-price competition</p>	<p>Oligopolists do not use the price when they compete with each other. They use non-price competition strategies such as</p> <ul style="list-style-type: none"> * aggressive advertising * branding * product differentiation * product loyalty * good service (e.g. after-sales services) * extended business hours (including Sundays and holidays) * door-to-door deliveries
<p>Collusion</p>	<p>Oligopolies are characterised by the act of collusion. Since there are few firms in the industry, it is easy for them to collude. They come together and form agreements to cooperate with each other and raise prices or restrict production in order to influence the price.</p> <p>There are two forms of collusion – overt collusion*(a.k.a. explicit collusion) and tacit collusion* (a.k.a. implicit collusion).</p> <p><u>Overt collusion:</u> This is open collusion which can be seen by everybody. An example of overt collusion is a cartel. A cartel is an open agreement between firms to fix prices or to limit supply in order to increase profits. The disadvantage is that cartels are unreliable. A firm can decide to cheat on others and sell at a lower price in order to attract buyers. Examples of cartels are the Organisation of Petroleum Exporting Countries (OPEC) and De Beers (diamond firm in South Africa).</p> <p><u>Tacit collusion:</u> Since it is illegal to form a cartel, oligopolists may decide to collude informally. A dominant firm in the industry is tacitly (implicitly, secretly) given a task to set the price. It takes the lead and announces the price increase. All other firms then follow the leader and start increasing their prices as well.</p> <p>NOTE: All forms of collusion are illegal. Firms are not allowed to come together to fix the price.</p>



2.2 Demand curve of the oligopolist

Unlike in the case of perfect competition and monopoly it is impossible to determine the demand curve facing the oligopolist. The quantity of goods the oligopolist produces is not determined by the consumers' demand only. The oligopolist must also consider the actions of other producers. One theory that can be used to determine the oligopolist's demand curve is what is called the **kinked demand curve**. According to this theory firms in an oligopoly are striving to protect and maintain their market share.

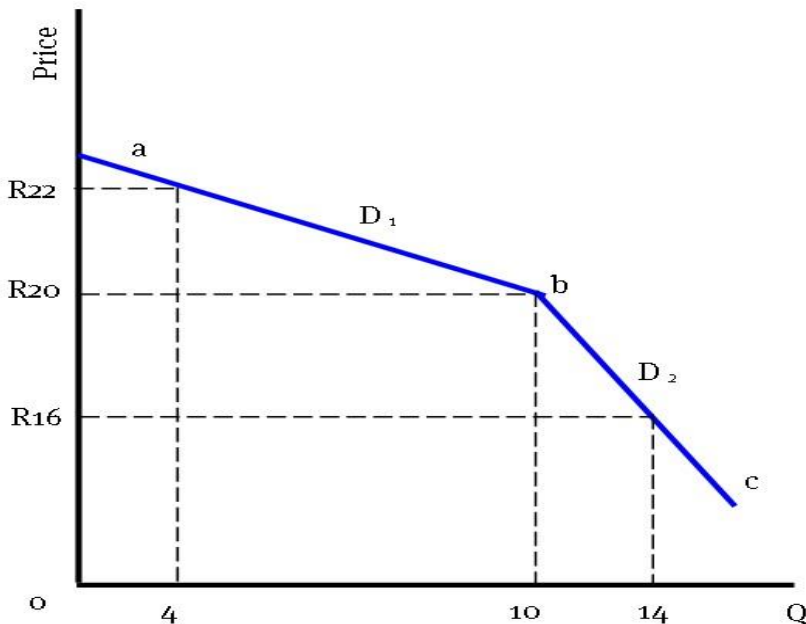


Fig 6: A kinked demand curve

Kinked demand curve.

A kinked demand consists of **two** sections. The top section (D_1) is very **elastic** and the bottom part (D_2) is highly **inelastic**. Suppose the market price is R20. At this price 10 units are produced and sold. Total revenue is $R20 \times 10 = R200$. If the firm tries to increase its profit by increasing the price by R2 to R22 it faces the risk that the quantity demanded will fall from 10 units to 4 units. Total revenue will fall to R88. A small change in price causes a huge change in quantity. Other oligopolists in the industry will not follow his lead. Therefore, the upper segment of the demand curve (D_1) shows that rivals will ignore price increases but match price cuts. The firm that increases the price will lose its customers to those that did not increase the price.

The firm can also try to increase its profit by reducing the price and thereby increase its total sales. If the price is reduced by R4 from R20 to R16, demand increases only by 4 units from 10 to 14 units. Demand is inelastic. There is a small increase in revenue to R224. Other firms will feel forced to also cut their prices because if they

don't they will lose customers to the firm that reduced prices. The increase in total revenue may be very small but firms feel obliged to reduce prices as well because they want to retain their market share. Therefore, the oligopolist is faced with a difficult situation because if he increases the price above the market price he will lose customers. If he reduces the price below the market price he will initiate a price war.

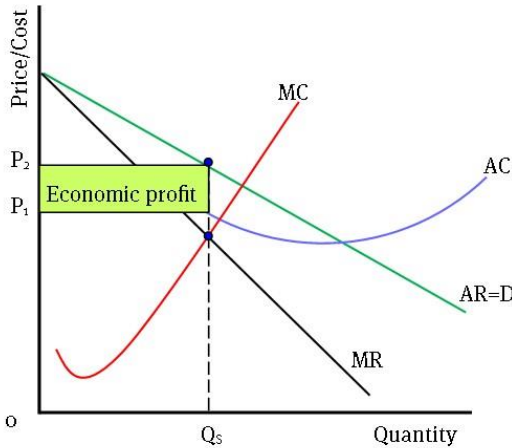
2.3 Comparison between the oligopoly and perfect competition

	Oligopoly	Perfect competition
Prices	Prices are higher because the oligopolist is a price-maker. There are few firms in the industry. It is easy for them to come together and fix a higher price.	Prices are lower because there are many buyers and sellers. The individual is a pricetaker. He has no control over price.
Output	Output is less under oligopoly than under perfect competition. They keep output low so that it will not depress the price.	There is more output because there are many sellers. The output by each firm increases market output.
Competition	It uses non-price competition strategies such as advertising and product differentiation to increase profit	Individual firms use price competition in order to attract customers.
Profit	The oligopoly makes economic profit in the short term and the long term because it is difficult for new firms to enter the market.	It can make economic profit in the short term but normal profit in the long-term. The economic profit made in the short term attracts competitors to enter the market in the long run.
Demand	The demand in the oligopoly market cannot be ascertained because it is affected by the reaction of other firms. As a result the kinked-demand curve shows the reaction of other firms when the price changes.	The demand curve is downward-sloping from left to right.

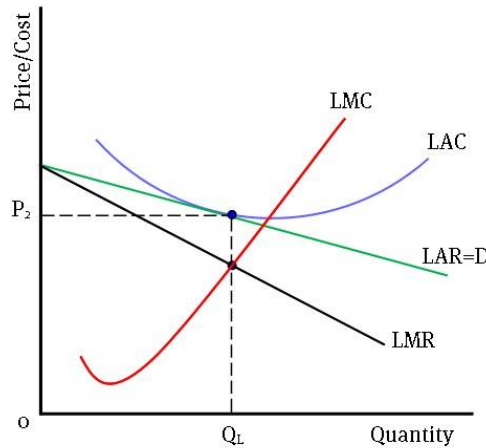
3. MONOPOLISTIC COMPETITION

a) Determination of prices and output in the short-run

As with the other market structures, profits are maximised at the output where $MC = MR$. The diagram is the same as for the monopolist, except that the demand curve (D/AR) and MR curve are **very elastic**. As with perfect competition, it is possible for the monopolistically competitive firm to make economic profit in the **short run**. This is illustrated by Fig 7 (a).



(a)



(b)

Fig 7: Equilibrium of the firm under monopolistic competition (a) short-run (b) long-run



b) Determination of prices and output in the long-run

Fig 7(b) depicts the equilibrium position of a monopolistic competition in the long-run. If a firm earns economic profit in the short-term, it attracts new firms in the long-run to also enter the market. As new firms enter, they will take some of the customers away from established firms. The demand for the established firms' products will therefore fall. Their long-run average revenue curve, LAR (which is also demand) will shift to the left, and will continue doing so as long as economic profits are earned. Long-run equilibrium will be reached when only normal profits are earned i.e. when there is no further incentive for new firms to enter. This occurs at point a where LAR is tangent to LAC in Fig 7(b). Output will be Q_L – where $LAR = LAC$. At any other output, LAC is greater than LAR and thus less than normal profit would be made.

TOPIC: MARKET FAILURE

TERM	DEFINITION
Allocative Inefficiency	When resources are not allocated in the right proportions and the product mix does not match consumers' tastes. It is possible to reallocate resources to make one person better off while not making someone else worse off
Allocative/Pareto Efficiency	Occurs when resources cannot be readjusted to make one consumer better off without making another consumer worse off. There is zero opportunity cost
Black market	An illegal market in which illegal goods are bought and sold or illegal prices are charged
Cost-Benefit Analysis	An analysis done by government which weighs the costs and benefits of a project to determine whether it should be carried out
Demerit Goods	Goods that are seen to be socially harmful e.g. cigarettes, gambling
Externalities	Costs or benefits to third parties which are not included in the market price of a good
Market Failure	When the forces of demand and supply fail to allocate resources efficiently
Maximum Price/ Price Ceiling	A price set below the equilibrium price/market price to make goods affordable
Merit Goods	Goods that are so beneficial to society that every individual should consume them irrespective of their income e.g. health care, education
Minimum Price/ Price Floor	A price set above the equilibrium price/market price to allow producers to make a fair profit
Minimum Wage	A wage rate set by the government, below which no employer can pay their workers. It is set above the equilibrium wage rate
Negative Externalities	A cost to a third party which is not included in a market price of a good. It is a difference between social cost and private cost. E.g. the harmful effect of a product e.g. pollution
Non-Excludable Goods	Goods whereby individuals can benefit even if they do not pay for it e.g. the television or the police force
Non-Rival Goods	Goods when consumed by one person will not reduce the consumption by another individual e.g. street lights
Positive Externalities	The benefit gained by a third party which is not included in the market price
Private Benefit	The gain a consumer gets from the use of a goods or the gain a producer gets from the sale of a product. E.g. The joy gained by a consumer from driving a car
Private Cost	The actual cost paid by a consumer when a good is purchased. E.g. R150 000 for a car
Producer Subsidies	A cash allowance given to a producer to lower the cost of production and allow more goods to be supplied at a lower price
Productive/ Technical Inefficiency	When resources are not used appropriately to produce the maximum number of goods at the lowest cost and best quality
Public Works Programme	A government initiative aimed at reducing poverty by creating temporary jobs in areas of infrastructure and other areas
SABS – South African Bureau Of Standards	An institute that monitors the quality of goods in South Africa
Social Benefit	The benefit gained by society from the use of a good or service. E.g. taxpayers pay for the maintenance of roads, society will benefit from fewer accidents. It is calculated by adding the private benefit and external benefit
Social Cost	The cost of a good or service which is paid by society. It is calculated by adding the private cost and external cost. E.g. the air pollution caused by cars, will affect people's health bills

Positive externalities

If people acknowledged the social benefit of a good, they would demand more of that good. The price of such a good would therefore increase. This is depicted in the Figure 8.3 below.

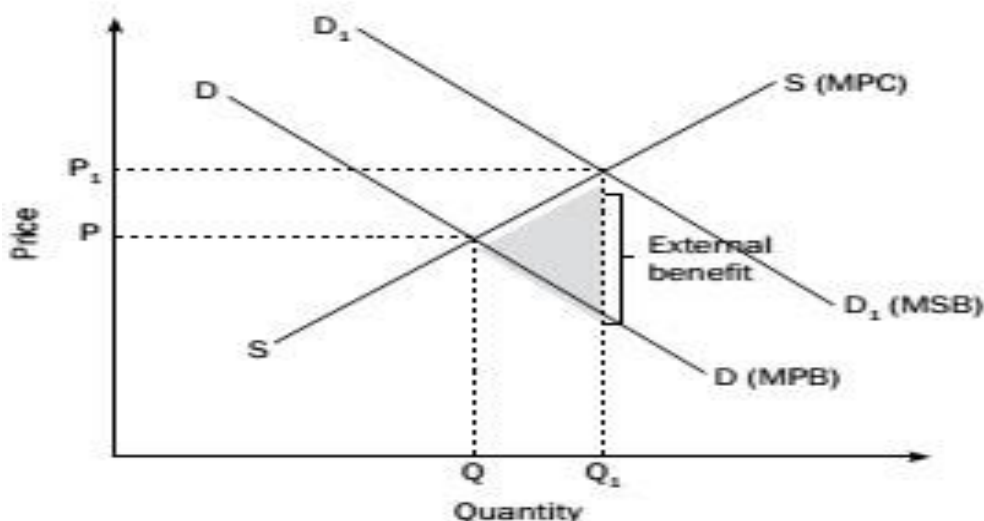


Figure 8.3 Positive externalities

From the graph it can be seen:

- The supply of education, which is also the marginal social cost, is represented by SS.
- The demand for school education, which is also the marginal private benefit (MPB) of the industry, is represented by DD. The cost of school fees is P and the quantity demanded and supplied is Q.
- If the cost of school fees is P, most learners will not be able to afford it.
- The demand curve D_1D_1 also represents the marginal social benefit (MSB), that is, the level of education that should be demanded.
- As a result of the benefits of education, MSB is greater than MPB.
- If the market is left to its own devices, a quantity Q will be produced at price P.
- There would be social inefficiency in the market since not enough education is being demanded.
- However, if social benefits are acknowledged, a quantity Q_1 will be produced at price P_1 .
- More education would be demanded, this will lead to social efficiency.
- The shaded angle represents the positive externality (the welfare gain) to society.

The government encourages positive externalities by:

- Advertising on the radio or television.
- Providing education, health care and other services at a low cost or free.
- Providing consumer subsidies.
- Consumer subsidies lower the cost of a good and encourage its usage.

8.3.3 Government intervention

Rules and regulations

a) Direct controls

The government can pass laws or use existing legislative framework to control businesses that generate negative externalities.

b) Imperfect markets

Firms in an imperfect market supply a limited quantity of goods and services at a very high price.

The government uses its laws on competition to prevent exorbitant prices charged by firms, to ensure entry to the market is free, prevent harmful collusion and encourage foreign competition which helps keep prices of goods low.

c) Establishing minimum wages

- When the government enforces a minimum wage, it means workers have to be paid a certain wage amount and not anything less than this.
- The Figure 8.4 below shows that if the wage rate is set at W , the corresponding demand and supply of labour will be Q .
- If a minimum wage of W_1 is set, the demand for labour will decrease from Q to Q_1 . Some people may become unemployed due to the introduction of a minimum wage.
- However, the quantity of labour supplied will increase from Q to Q_2 .
- More people will offer their labour because of the higher wage.

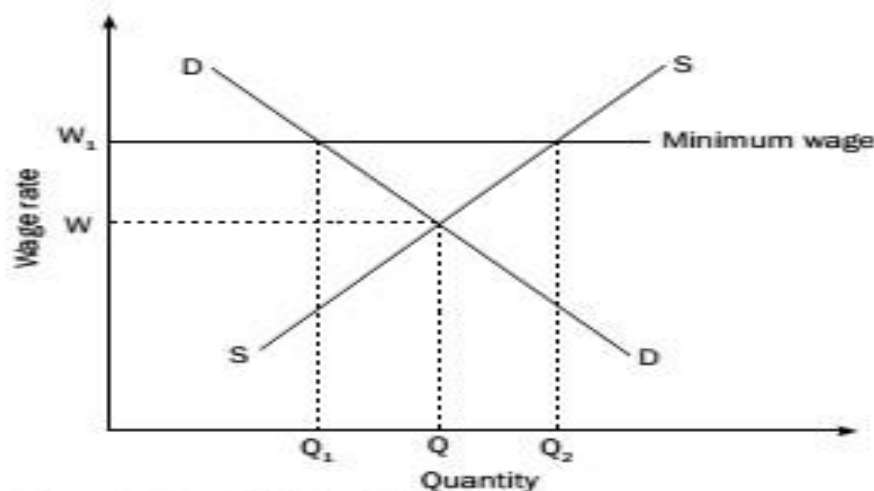


Figure 8.4 Establishing minimum wages

d) Setting maximum prices/price ceilings

- The government sets a maximum price ceiling below the market price to make goods more affordable.
- Maximum prices allow the poor greater access to certain goods and services.

- A maximum price is set on goods such as basic foods, housing and transport.
- In South Africa the price of petrol, diesel fuel and paraffin are controlled at their maximum prices.

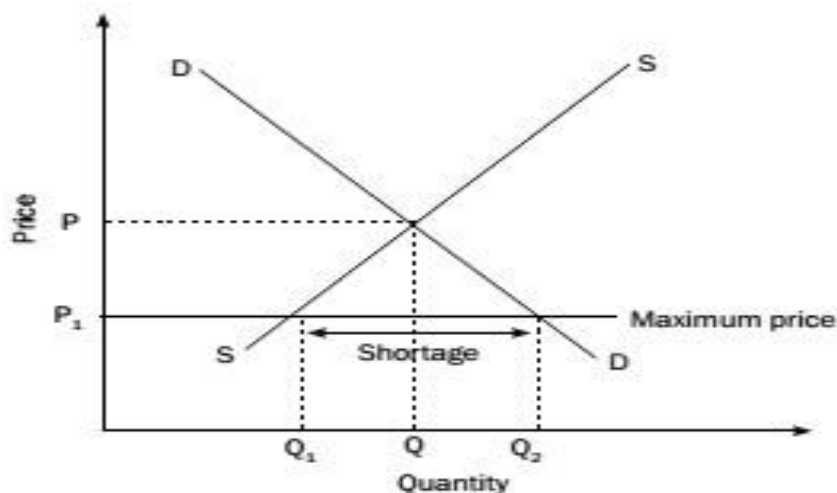


Figure 8.5 Setting maximum prices

- Initially the market equilibrium price is P and equilibrium quantity is Q .
- The government intervenes and passes a law that milk cannot be sold for more than P_1 .
- The effect of this maximum price is that quantity supplied decreases to Q_1 and quantity demanded increases to Q_2 .
- There is a shortage of milk equal to the difference between Q_1 and Q_2 .
- A shortage creates a problem of how to allocate milk to consumers.
- Black markets often develop where people can obtain milk. A black market is an illegal market in which either illegal goods are bought and sold or illegal prices are charged.
- Maximum prices may cause a shortage of goods but they do improve the welfare of some consumers since goods can be purchased at lower prices.

e) Setting minimum prices/price floors

- The government sets a minimum price at some point above the market price.
- This is done to enable producers to make a comfortable profit and thus encourages them to supply important essential goods.

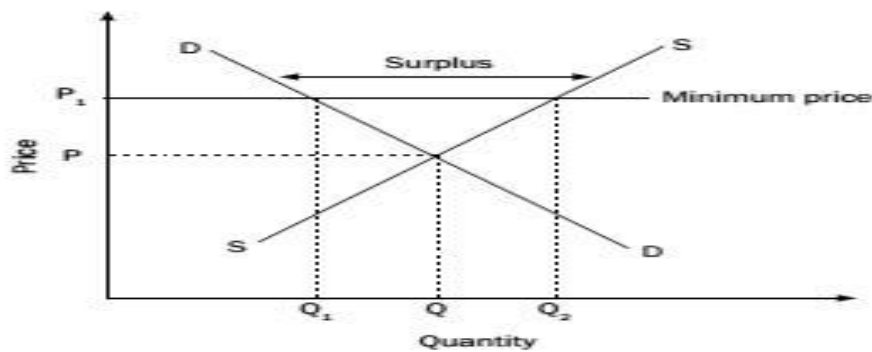


Figure 8.6 Setting minimum prices

- Consider the market for wheat.
- The market equilibrium price is P and the equilibrium quantity is Q .
- If the government sets a minimum price at P_1 , farmers will earn greater profits and supply more wheat. Quantity supplied will therefore increase to Q_2 .
- However, quantity demanded will decrease to Q_1 .
- There would be a surplus of wheat equal to the difference between Q_2 and Q_1 .
- A surplus means the government will have to buy the extra wheat and dump it locally or abroad.
- Although minimum prices may cause a surplus they do encourage the supply of important food stuffs.

f) Taxes and subsidies

Levying of taxes

Governments 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.

Providing Producer 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.

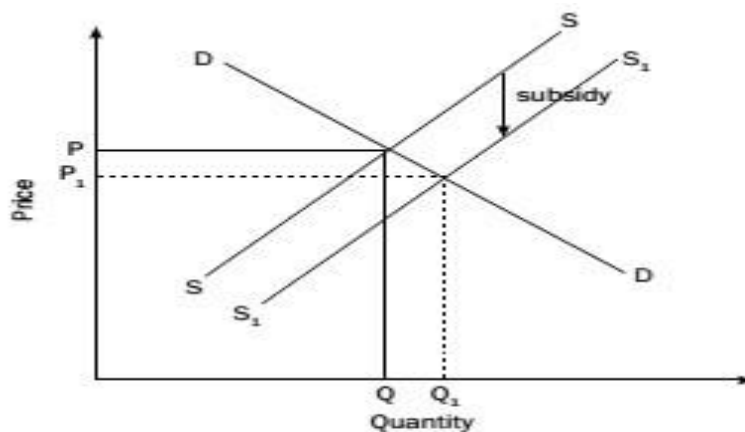


Figure 8.7 Taxes and subsidies

For example, if we look at Figure 8.7:

- The market price of rice is P and the corresponding quantity is Q .
- If the government subsidises the production of rice, the market price will decrease to P_1 with corresponding quantity Q_1 .
- The lower price, P_1 , allows the poor to purchase more rice.

COST BENEFIT ANALYSIS

- **Cost-benefit analysis (CBA)** is a standard method used to compare the social cost and benefits of alternative projects or investments.
- Cost and benefits are measured and then weighed up against each other in order to generate criteria for decision making.
- We use one of 3 decision criteria:

Net present value (NPV)	Internal rate of return (IRR)	Benefit-cost ratio (BCR)
The present value of an investment project, found by discounting all present and future receipts and outgoings at an appropriate rate of interest; if the net present value calculated is positive, it is worthwhile investing in a project.	The interest rate at which the net present value of a project is zero (0); a project is worth investing in if its IRR is greater than the rate of interest.	The BCR for a project is the ratio between the sum of expected benefits and its cost.

CBA is, in essence, an accounting procedure for investment whereby the total cost of the particular project is weighted against its total benefits. Government usually uses CBA to see whether they should undertake a certain project.



Rationale

This includes understanding the rate of return on a project and the idea that future costs and benefits can be discounted in reverse to give its present value. This determines the rate of return on a project and allows informed decisions to be made that are in the best interests of society.

Price mechanisms

- The procedure involves estimating the money equivalent of the benefits of a project and comparing these benefits estimates with the cost of providing the good or service.
- It is relatively easy to measure private costs and benefits as they go through the price mechanism.
- But in practice, it is more difficult to attach monetary values to external costs and benefits.
- One way is by using shadow prices, based on opportunity costs.
- Def. of shadow prices: Relative prices of goods, services and resources that are proportional to their true opportunity cost for the economy, taking account of any external economies and diseconomies.
- E.g. to place a value on the benefits drivers would receive on completion of a new freeway, we could estimate the driving time that would be saved, and then multiply this by the average wage rate.

- Money now is worth more than money later.
- The relative levels of costs and benefits as well as the distribution of these must be considered. E.g. a project should go ahead if the investors (those who gain) can compensate those who lose, and still experience a net gain.

Application

- The calculation of a CBR is often the end result of the study.
- The numerator of this ratio is defined as the present value of all of the expected economic benefits attributable to a proposed undertaking.
- E.g. to calculate the monetary value for a public park or an art museum, shadow prices (benefits) may be used to calculate the value of the enjoyment of these facilities.
- The denominator of the CBR is defined as the present value of the cost of undertaking and operating the project. If it is a large capital investment project there are 2 types of costs: capital cost and operation, maintenance and repair cost.
 - Capital costs occur before the project begins to produce outputs; the remaining costs are future expenses.
 - On the basis of these definitions, the CBR is defined as the value of benefits of a programme to the value of the programme's cost:



$$\text{CBR} = \frac{\text{Present value of economic benefits}}{\text{Present value of economic costs}}$$

- If the ratio is greater than 1, the project is judged economically worthwhile.
- If the ratio is equal to 1, public expenditure adds nothing.
- If the ratio is below 1, it detracts from economic well-being.

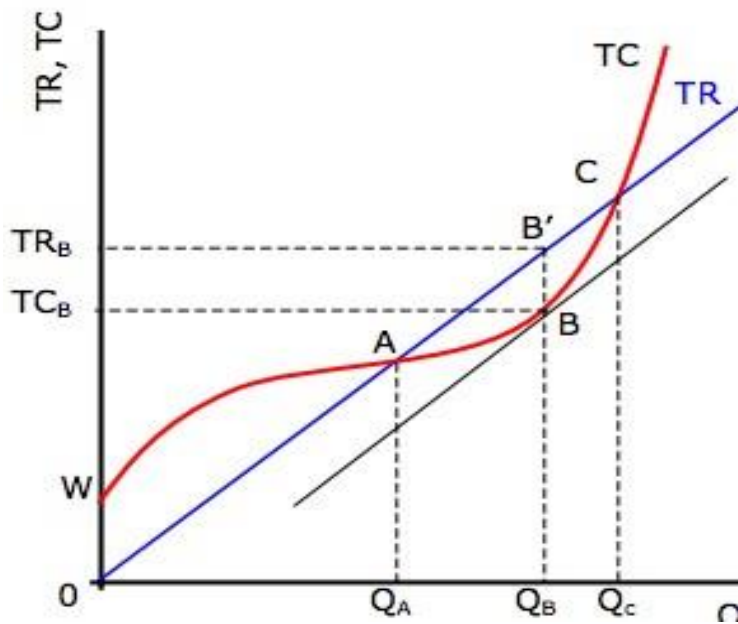
The uses of the CBA in practice

- In practice, a CBA tries to answer the question: 'Do the gains to the people exceed the sacrifices required of them?'
- If the answer is yes – CBA > 1
- If no – CBA < 1

ACTIVITIES

Perfect Markets.

ACTIVITY 1



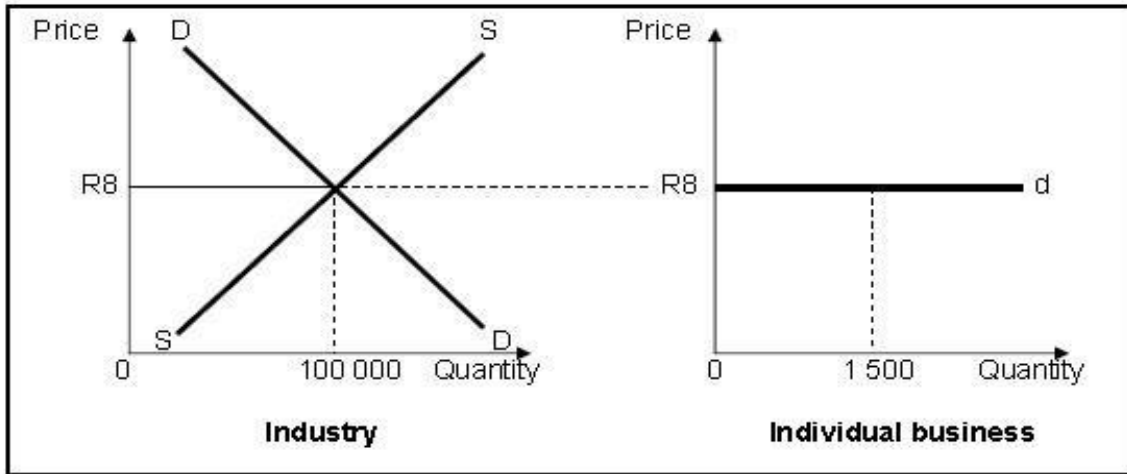
- 1.1.1 Identify profit maximizing output level on the graph. (1)
- 1.1.2 What type of profit does the firm make at points A and C? (1)
- 1.1.3 Describe the term *breakeven* point. (2)
- 1.1.4 Why does the firm incur total costs when output is still at zero (2)
- 1.1.5 How does the price charged in this market structure benefit consumers? (4)

ACTIVITY 2

Study the graph below and answer the questions that follow

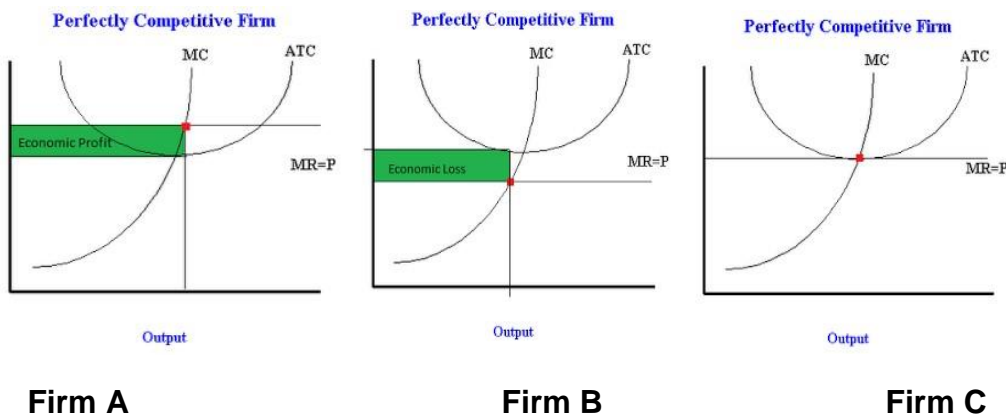
Diagram A

Diagram B



- 2.1 Which diagram represent a single firm from the above diagrams. (1)
- 2.2 Provide another name for curve **d** in diagram B. (1)
- 2.3 Describe the term *industry*. (2)
- 2.4 How is the price determined by the firm in diagram B. (2)
- 2.5 Explain the effect on supply if more firms decide to leave the industry (4)

ACTIVITY 3

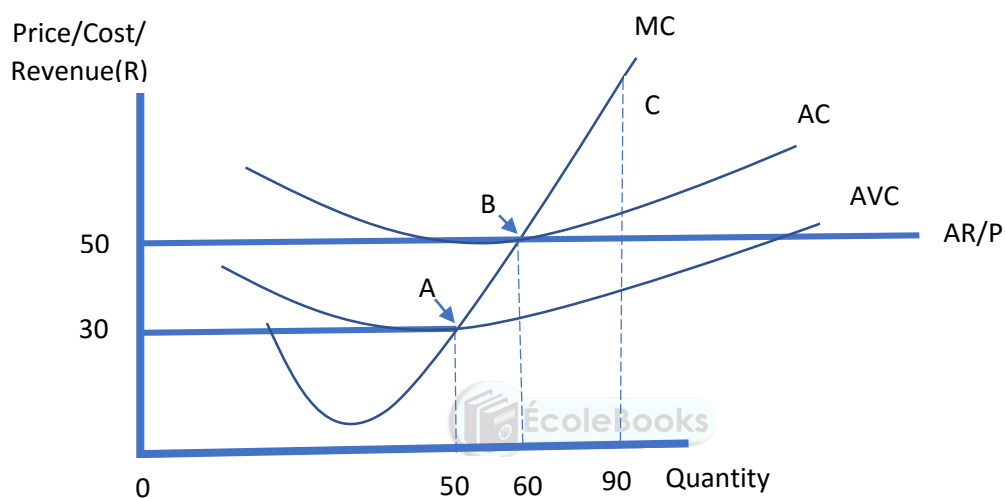


- 3.1 Identify the market structure depicted above. (1)
- 3.2 Which firm above can draw more suppliers into the market? (1)
- 3.3 Briefly describe the term shut down point (2)
- 3.4 Why is the demand curve for an individual firm horizontal? (2)
- 3.5 How will the equilibrium position in Firm B change in the long run? (4)

Activity 4

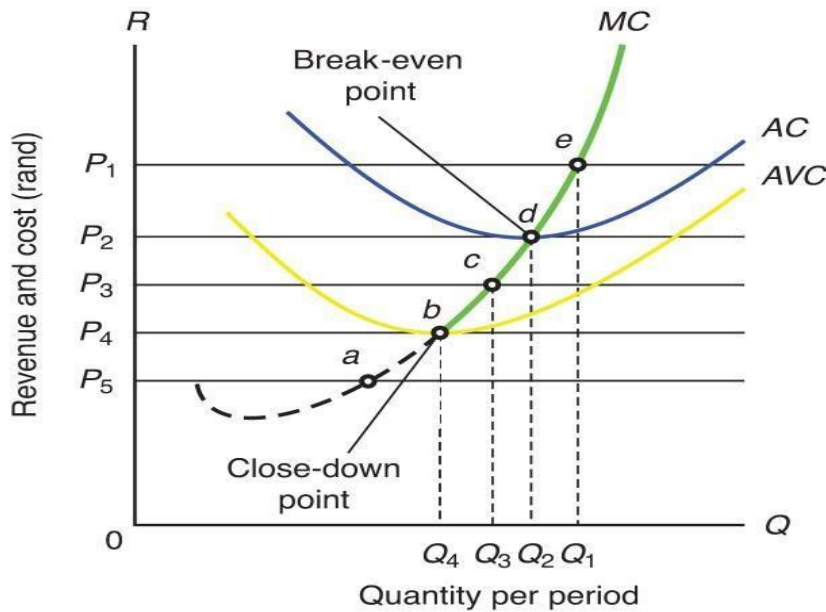
4.1 Study the graph below and answer the questions that follow.

PERFECT COMPETITION- THE INDIVIDUAL FIRM



- 4.1.1 Identify the optimal level of output from the graph. (1)
- 4.1.2 What type of profit is made by this firm? (1)
- 4.1.3 Briefly explain implicit costs. (2)
- 4.1.4 Why will the above firm not produce at a price lower than R30? (2)
- 4.1.5 How does competition Act contribute towards ensuring free competition? (4)

ACTIVITY 5



- 5.1 Identify the point that represents Economic loss on the graph? (1)
- 5.2 What is the profit maximizing output at price **d**? (1)
- 5.3 Which curve represents a supply curve? (2)
- 5.4 Why does the firm close down at point **b** on the graph? (2)
- 5.5 Explain the importance of point **B** in relation to production and cost (4)

Monopoly

Activity 1

1.1 Study the picture below and answer the questions that follow.



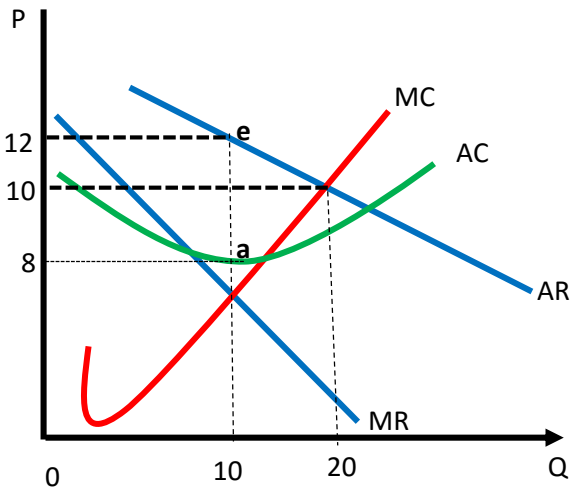
(Sunday Times 17 November 2019)

1.1.1 Identify the type of market structure depicted in the cartoon. [1]

- 1.1.2 How many firms usually dominate this type of market. [1]
 1.1.3 How are artificial monopolies created? [2]
 1.1.4 Why do monopolists make profit in the long run. [4]

ACTIVITY 2

2.1 Study the graph below and answer the questions



- 2.1.1. Identify the price charged by this monopolist. (1)
 2.1.2. Which one is a price of the perfect market. (1)
 2.1.3. Briefly describe a normal profit. (2)
 2.1.4. Why does the MR curve runs below AR curve. (2)
 2.1.5. How can monopolist fail to make economic profit? (4)

Monopolist can fail to make economic profit:

- 2.2 Distinguish between natural and artificial monopoly. (8)
 2.3 How does the monopoly and perfect market differ in terms of demand curve? (8)
 2.4 “Government pass laws in order to curb monopolies, but on the other hand governments then create monopolies with legislation such as that on patents on medicine. This seems strange. Explain how this happens. (8)

ACTIVITY 3

3.1 Study the table and answer the questions that follow.

Price	Quantity	Total Rev	Average. Rev	Marginal Rev
0	-	-	-	-
100	10	1000	100	100
90	20	1800	90	80
80	30	2400	80	60
70	40	2800	70	A
60	50	3000	60	20
50	60	3000	50	0
40	70	B	40	-20
30	80	2400	30	-40
20	90	1800	20	-60
10	100	1000	10	-20



3.1.1. Identify the best price for the monopolist in the table above. (1)

3.1.2. What is the relationship between price and quantity in the monopoly? (1)

3.1.3. Briefly describe the monopoly. (2)

3.1.4. How does the monopolist maximize the profit? (2)

3.1.5. Calculate the values of A and B in the table above. (4)

3.2 Discuss any TWO characteristic of a monopoly. (8)

3.3 “Government pass laws in order to curb monopolies, but on the other hand governments then create monopolies with legislation such as that on patents on medicine. This seems strange. Explain how this happens. (8)

ACTIVITY 4

4.1 Study the cartoon below and answer the questions that follow:



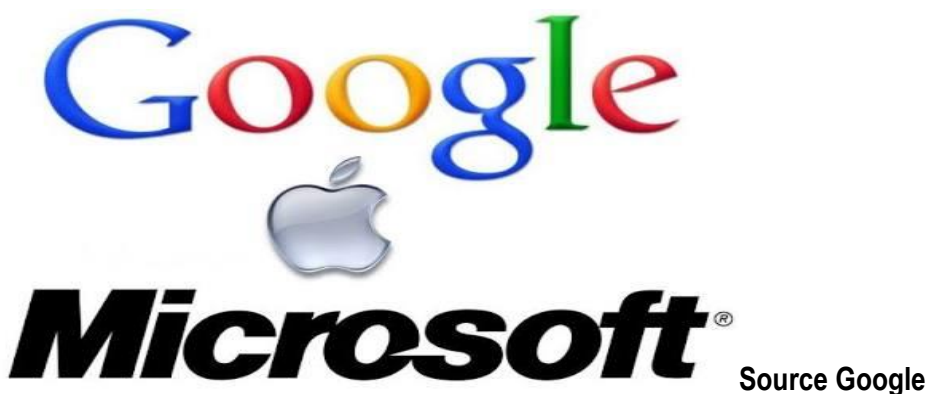
Source Google

- 4.1.1 What type of market structure is depicted in the cartoon? [1]
- 4.1.2 Name one type of collusion. [1]
- 4.1.3 Briefly describe the term cartel. [2]
- 4.1.3 Explain why the markets for airlines and automobiles are seen as good examples of oligopolies. [2]
- 4.1.5 Explain how a car manufacturer operating in an oligopolistic market expand the firm. [4]
- 4.2 Draw and discuss the demand curve for the above-mentioned market structure. [8]



ACTIVITY 5

5.1 Study the picture and answers below.



Source Google

- 5.1.1. How many firms in this industry? (1)
- 5.1.2. What is the nature of product sold in this industry? (1)
- 5.1.3. Briefly describe duopoly. (2)
- 5.1.4. Discuss inefficiency of oligopoly. (2)
- 5.1.5. How does oligopoly make it difficult to enter the market? (4)

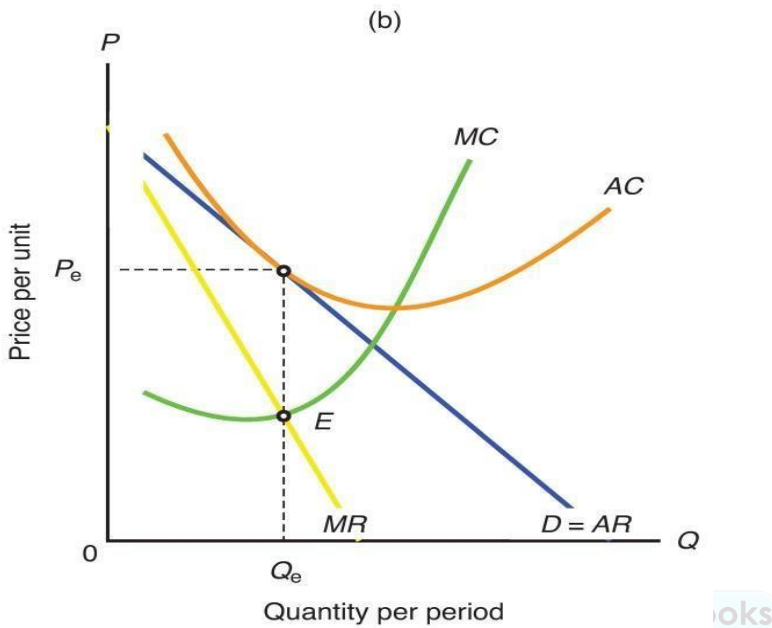
5.2. Briefly discuss how do oligopolies compete to increase the market share. (8)

5.3 How do oligopolies minimize uncertainties and maximizing profit. (8)

ACTIVITY 6

Study the graph below and answer questions that follow

MONOPOLISTIC COMPETITION



6.1 Identify equilibrium position depicted on the graph. (1)

6.2 What determines the optimum production level in a monopolistic market? (8)

6.3 Describe the term monopolistic competition. (2)

6.4 Explain why the AR and MR curves are two different curves. (4)

6.5 Explain **hybrid structure** and **entry** as characteristics of monopolistic competition (8)

6.6 How do monopolistic competitors use non-price strategies to win the market share? (8)

- 8.1.1 Identify government intervention depicted in the cartoon. [1]
- 8.1.2 Give one example of workers that can benefit from minimum wage? [1]
- 8.1.3 Briefly describe the concept minimum wage. [2]
- 8.1.4 Why does the government impose minimum wage? [2]
- 8.1.5 How will the minimum wage affect the economy? [4]

Activity 9

10.1 Study the case study below and answer the questions that follow:

Trim wastage, reward good people, punish bad contractors: Gordhan on Eskom

04 March 2020 - 16:52 BY CHRIS YELLAND

Are electricity prices in South Africa too high or too low - and if so, what is to be done about this?

Electricity prices are part of what we would call administered prices in the economy. That would include port charges, freight charges and other tariffs that are generally within government control. International comparisons seem to indicate that electricity prices in South Africa are not too high. South Africa has its own structural challenges in terms of certain industries like mining and manufacturing - and the difficulties in these sectors need to be taken into account by Eskom itself. Equally, Eskom has its own internal dynamic that it needs to modify. This internal dynamic keeps pushing tariffs up. While there has been no increase in energy delivered, there has been a fourfold increase in revenue, largely resulting from tariff increases. The flipside of this coin is managing costs within Eskom itself. Pricing and energy supply are one side of the equation. The other side is energy efficiency. There has to be a greater focus and push from industry to become more energy-efficient in the way our limited electricity resources are used, and also to contribute to our climate-change goals.

- 9.1.1 Name one product with administered price. [1]
- 9.1.2 Which body regulates electricity in South Africa. [1]
- 9.1.3 Briefly describe the term administered prices. [2]
- 9.1.4 Explain the impact of electricity regulator on consumers. [2]
- 9.1.5 How does inefficiency of Eskom affect the economy? [4]

ECONOMIC PURSUITS

TOPIC	ECONOMIC GROWTH AND DEVELOPMENT
Term	Definition
Accelerated and Shared Growth initiative for South Africa (ASGISA)	An initiative to promote development strategies ,e.g. infrastructure and skills development
Broad Based Black economic empowerment (BBBEE)	Has the goal of the sustainable (able to continue)distribution of wealth across as broad a spectrum of South African society as possible, especially the most vulnerable such as women, mainly through ownership and management of business enterprises
Black economic empowerment (BEE)	An earlier policy similar to BBBEE, with the aims of distributing wealth to and developing skills in black citizens in post-apartheid South Africa
Development Bank of Southern Africa (DBSA)	Promotes development in the Southern African region by financing important development projects
demand-side approach	The focus is on attempts to increase aggregate demand in an economy. Fiscal and monetary policy can be used
economic development	The process by which the standard of living improves
economic development policy	A policy that involves the interaction of economic, social and human development
economic growth	An increase in the productive capacity of an economy over time. It is a change in the real GDP
economic growth policy	A policy that helps to increase the annual total production or income in the economy
Growth, employment and redistribution (Gear)	A strategy to promote economic growth, increase employment and redistribute income
Globalisation	The worldwide interaction of economies with trade as an important element
Integrated Manufacturing Strategy (IMS)	A strategy to strengthen institutional capacity to deliver services that will facilitate development
Joint initiative on Priority Skills acquisition (JIPSA)	An initiative to aid the development of urgently needed skills to facilitate job creation
Life expectancy	Expresses in number of years how long a child born today is expected to live
National Growth Path (NGP)	Initiatives to stimulate economic growth

North-South divide	Refers to the developed countries in the Northern hemisphere and the developing countries in the Southern hemisphere
Public and Private Sector Partnership (PPP)	These are contracts between the public sector institution/ municipality and a private business, in which the design financing and operation of public sector are managed by the private business
Reconstruction and Development Programme (RDP)	A development policy to improve service delivery to the poor and create an environment for human development
South African Reserve Bank (SARB)	Central bank of South Africa with the main goal to maintain price stability, thereby promoting balanced and sustainable growth
Small, Medium and Micro Enterprises (SMMEs)	A small business that has small share of the market place, operates independent of larger enterprises; employs few people and is managed directly by owners
Supply-side approach	Policies aimed at increasing the aggregate supply

ECONOMIC GROWTH AND DEVELOPMENT

ECONOMIC GROWTH VS ECONOMIC DEVELOPMENT

GROWTH	DEVELOPMENT
<ul style="list-style-type: none"> ▪ Increase in the country's GDP/productive capacity ▪ Focuses on the production of goods and services ▪ Increase in the country's real gross domestic product ▪ Growth leads to development 	<ul style="list-style-type: none"> ▪ Improvement in the standard of living of people/in the real per capita income of citizens overtime ▪ Focuses people's standard of living, self-respect and freedom of choice ▪ Measured by HDI

DEMAND SIDE APPROACH: approach that is used to stimulate economic growth by increasing the **aggregate demand**, through making discretionary changes in **monetary and fiscal policies**.

International best practice argues that developing economies should run their economies in a way that creates economic growth. This would help social transformation, human capital formation and redistribution of income.

Components of aggregate demand (C, I, G & X)

MONETARY POLICY: the SARB through **interest rates and money supply** in the economy uses the following instruments:

- Interest rates changes
- Open market transactions
- Moral suasion
- Cash Reserve requirements

FISCAL POLICY: in order for the government to stimulate macroeconomic growth and employment and ensure redistribution of wealth uses the following instruments:

TAXATION

- Progressive personal income tax
- Wealth taxes

GOVERNMENT SPENDING

- Cash benefits
- Benefits in kind (natural benefits)
- Investment spending
- Public works programmes
- Land reinstatement and redistribution
- Subsidies on properties



SUPPLY SIDE APPROACH: approach that is used/aimed to stimulate economic growth by increasing the aggregate supply, in the long term without causing inflation.

NOTE: when tax rates are lowered, more earnings, savings and investments will be encouraged, as well as removing rigid regulation, this will lead to an expansion in economic activity. (therefore both **monetary and fiscal policies** are also applied)

Improvement of **efficiency and effectiveness of markets** whereby they operate equitably and inclusively

- Reducing unnecessary regulations
- Increasing competition (Competition Act to reduce anti-competitive behaviour by companies)
- Privatisation (some state-owned companies sold to private owners, this serves to reduce state intervention in the economy and increase efficiency in the companies -

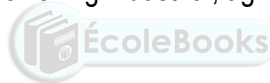
Business efficiency where greater output can be achieved through:

- taxes must be collected efficiently – tax rates should be reduced (influenced by Laffer curve)
- rigid regulations applying to businesses should be relaxed
- Free advisory services must be available -
 - The **cost of doing business** must be lowered:
 - The cost of inputs should be low as possible (**infrastructure**)
 - Reliable and plentiful supply of water and energy
 - Efficient and low-cost transport and communication system -
 - **The factors of production** - the following is important:
 - Human resources (education & training, better utilisation, productivity)
 - Natural resources (availability, better utilisation)
 - Capital (capital formation)
 - Technology (advancement & progress)
 - Entrepreneurship (successful)

EVALUATION OF SA POLICIES TO GROWTH & DEVELOPMENT

Growth and Development policies:

- **Growth policies:** aim to achieve macroeconomic objectives
- **Development policies:** aim at achieving industrial, agricultural and human development



MAJOR GOVERNMENT POLICIES, STRATEGIES, INITIATIVES SINCE 1994

- **RDP: (1994)** as the main strategy aimed to alleviate poverty and address the inequalities and shortfalls in social services by focusing on **job creation, welfare, housing, healthcare, land reform, education, training, water and sanitation.**
- **GEAR: (1996)** macroeconomic strategy aimed at strengthening **economic development, broadening of employment, redistribution of income and socioeconomic opportunities in favour of the poor.**
- **ASGISA: (2006)** aimed at **reducing unemployment and poverty by half by 2014**
- **JIPSA:** initiative that was established to support ASGISA. **To solve the problem of shortage of skilled labour (skills development)**
- **EPWP:** **nationwide** government intervention to **create employment** using labour intensive methods and give people skills.
- **New Growth Path (NGP): (2010)** as an approach to accelerate economic growth and employment i.e. **generate 5 million new jobs by 2020**
- **National Development Plan (NDP):** aim to **transform SA by 2030**, set out to expand economic opportunities through **investment in infrastructure, more innovation, private investment, and entrepreneurship.**

- **SBDPP**: designed to deliver **support and services to small, medium and micro enterprises**
- **BBBEE**: designed to assist in the **transformation and redress of previously disadvantaged groups**.

The supply-side policies measures

Reduction of costs

- **Infrastructural services**: reasonable charge and efficient transport, communication, water services and energy supply.
- **Administrative costs**: these costs include inspection, reports on applications of various laws, regulations and by-laws, tax returns and returns providing statistical information. It adds to costs and the businesses carry a heavy burden.
- **Cash incentives**: it includes subsidies for businesses to locate in neglected areas where unemployment is high and compensation to exporters for certain costs they incur in development of export markets.

Improving the efficiency of inputs

- **Tax rates**: low tax rates can serve as an incentive to workers. It will improve the productivity and output.
- **Capital consumption**: replacing capital goods regularly creates opportunities for businesses to keep up with technological development and better outputs
- **Human resource development**: to improve the quality of manpower by improving health care, education and training.
- **Free advisory service**: these promote opportunities to export.

Improving the efficiency of markets

- **Deregulation**: removal of laws, regulations and by-laws and other forms of government controls makes the market free.
- **Competition**: encourages the establishment of new businesses
- **Levelling the play field**: private businesses cannot compete with public enterprises

NORTH/SOUTH DIVIDE

Distinguished with the following:

Unequal standard of living

- -real GDP per capita
- -life expectancy
- -education, literacy level

Globalisation inequalities/challenges

- -poverty level
- -economic growth
- -production and trade

Environment

- Mass production and consumption

Sustainable development

- pattern of development

REGIONAL DEVELOPMENT

INDUSTRIAL DEVELOPMENT POLICIES IN SOUTH AFRICA

INDUSTRIAL DEVELOPMENT: is the increase in the number and size of industries in the country, which is facilitated by the government through the development of **industrial development policies**

Reasons for industrial development:

- Necessary to bring about economic development i.e. it's an engine, diversification of the economy
- Essential in stimulating economic development, maintaining macroeconomic stability
- Industrialisation causes forward and backwards linkages,
- Creates employment, increases investment, increases productivity

INDUSTRIAL DEVELOPMENT POLICIES:

The following industrial policies have been developed since 1994

NATIONAL INDUSTRIAL POLICY FRAMEWORK (NIPF)

Targets at halving unemployment and poverty by 2014 Aims

- Diversification of the economy
- Intensifying industrialisation process in the long run
- Promote labour intensive industries

- Promote broad-based industrialisation
- Development on the African continent – increase potential on large scale production

INDUSTRIAL POLICY ACTION PLAN (IPAP 1 – 10)

Is an action plan of implementing NIPF. It was developed to fast-track industrialisation in order to address shortcomings experienced in the manufacturing sector.

Aims

- Structural change
- Diversification of goods
- Intensification of industries
- Labour-intensive industries
- Historically disadvantaged people
- Involvement of the African continent

FOUR LEADING SECTORS OF THE NIPF

- Capital/transport equipment and Metals
- Automotive assembly and Components
- Chemicals, plastic fabrication and Pharmaceuticals
- Forestry, Pulp, and paper, and Furniture

INDUSTRIAL DEVELOPMENT STRATEGIES

NATIONAL RESEARCH AND DEVELOPMENT STRATEGY (NRDS)

- Researches on technology
- Researches on diseases
- Human resources
- Globalisation

INTERGRATED MANUFACTURING STRATEGY (IMS)

Focuses on six key performance areas

- Growth
- Competitiveness
- Employment
- Small business development
- Black economic empowerment
- Geographic spread of economic activity

REGIONAL DEVELOPMENT: is a multidisciplinary process that systematically directs all aspects of human, economic and physical development in specific geographic areas called regions, especially in underdeveloped areas.

Aims:

- Stimulate development in underdeveloped areas
- Reduce unequal development of economic activities
- Coordinate and implement national and regional industrial policies
- Optimum spatial distribution of economic activities
- Prevent the emergence on new imbalances

Best practice

Guidelines:

- Total development as a multidimensional process
- Development of people, for people, by people
- Development from within
- Development from below
- Cooperation between the private and the public sectors and local community



SOUTH AFRICA'S ENDEAVOURS

SPATIAL DEVELOPMENT INITIATIVES (SDI)

- Is an interdepartmental strategy to promote sustainable industrial development in areas where poverty and unemployment are at the highest.
- It is a link between important economic hubs and regions in a country, aiming at fast tracking investment through PPPs. All SDIs are based on partnership between public and private sectors (PPPs)
- Examples:
 - **Richards Bay**
 - **Lubombo**
 - **Wild Coast**
 - **Fish River**
 - **Platinum**
 - **Phalaborwa,**
 - **West Coast Investment Initiative**

Aims

- Stimulate economic growth in selected strategic locations

- Generate economic growth and faster sustainable economic development
- Create employment
- Develop infrastructure projects
- Develop inherent economic potential
- Ensure rapid planning and development
- Restructure the apartheid economy
- Maximise certain types of private investment
- Exploit underutilised location & economic advantages for export orientated growth
- Establish public-private partnerships (PPP)

CORRIDOR/S

Is / are tracks of land that form the passageway allowing access from one area to another.

- Corridors in South Africa are spatial areas that offer specific advantages to mining, manufacturing and other businesses.
- The advantages also include the presence of existing infrastructure and the specialisation of products or services.
- These corridors are development areas within South Africa and are the development priorities of all development agencies.
- The DTI provides help in support of the development corridors.
- Eg. the Maputo corridor, that starts in Gauteng and extends through Mpumalanga to the Maputo port, offers opportunity to the transport industry or the Phalaborwa sub-corridor in the Northern Province offers opportunities for mining and related activities.
 - **Examples: Maputo corridor, Coast-to-Coast corridor**

NOTE: Learners must be able to identify/indicate (SDI and corridors) on the SA map

THE SDI PROGRAMME	COMPONENTS	THE LOCATION	THE FOCUS POINTS
<i>a) Spatial development initiatives</i>	1. Maputo Development Corridor	Links Mpumalanga with Gauteng and Maputo in Mozambique	Agriculture, mining, tourism, infrastructure, manufacturing
	2. Lubombo Corridor	From St Lucia in KwaZulu-Natal along the Indian Ocean coast line to Ponto do Quro in Mozambique	Agri-tourism, education, craft, commercial and agriculture se
	3. Richards Bay SDI	Includes the Durban and Pietermaritzburg manufacturing nodes	Industrial projects and tourism

	4. Wild Coast SDI	Former Transkei	Agri-tourism, forestry
	5. Fish River SDI	Fish River region and East London	Industrial projects and forestry
	6. West Coast Investment Initiative	Saldanha	Fishing
	7. Platinum SDI	Rustenburg	Tourism, manufacturing, agriculture and mining
	8. Phalaborwa SDI	Phalarborwa	Mining, agriculture
	9. Coast-2-Coast Corridor	Walvis Bay – Johannesburg Maputo (Trans-Kalahari)	Tourism, Industries and transport

INDUSTRIAL DEVELOPMENT ZONES (IDZs)

A purpose built industrial estate, physically enclosed and is linked to an airport or seaport/harbour with export as the main objective.

Aims

- Encourage international competitiveness in manufacturing
- Encourage exportation of SA goods
- Provide a location for strategic investment
- Encourage and maximise the use of infrastructure
- Link the domestic industries with the zone-based industries - Generate employment
- **Examples:** Coega, Richards Bay, East London, Saldana Bay, Dube Trade port

SPECIAL ECONOMIC ZONES (SEZs)

Are geographically designated areas of a country set aside for specifically targeted economic activities, supported through special arrangements and systems. They enjoy tax relief and support systems to promote industrial development.

- There are plans to reduce tax to 15% as an incentive to attract new industries.
- The DTI has indicated that the existing IDZs where special tax incentives do not apply, would be graduated into SEZs.

Note: the existing IDZs are being changed into SEZs in order to address the shortcomings by IDZs

Aims

The aim of creating SEZ is to attract:

- only new business

- business which are developing a new product line –
 - Business which are expanding their volume.
-
- Expand the strategic industrialisation focus to cover diverse regional development
 - Provide a clear, predictable and systematic planning framework
 - Clarify and strengthen governance arrangement
 - Provide a framework for a predictable financing framework to enable long term planning.

Benefits

- Preferential Corporate Tax
- Building Allowance
- Employment Incentive
- Customs Controlled Area
- 121 Tax allowance

INCENTIVES (refer to Focus page 209 for explanations)

- Skills Support Programme (SSP)
- Small and Medium Enterprise Development Programme (SMEDP)
- Critical Infrastructure Programme (CIP)
- Black Business Supplier Development Programme (BBSDP)
- Seda Technology Program (STP)
- Strategic Investment Programme (SIP)
- Foreign Investment Grant (FIG)
- Duty/Custom free incentives
- Services to Business Processes

APPROPRIATENESS OF SA's REGIONAL DEVELOPMENT POLICIES

It must be evaluated in terms of the following benchmark criteria:

- **Free market orientation** – minimum government intervention allowing market forces and profit motives to efficiently allocate resources
- **Competitiveness** – businesses should be more competitive and not dependent on government financial aid.
- **Sustainability** - the capacity of the region has to support its own development, such that employment and sustainable development is achieved.
- **Good governance** – development strategies should be managed effectively and free of corruption.
- **Provision of resources** – sufficient resources should be provided in resource – poor areas, such as the development of infrastructure.

- **Investment on social capital**- improving the quality of education and healthcare in regions.
- **Integration** – an integrated approach should be followed, ensuring that benefits in one part of the 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.

SMALL BUSINESS DEVELOPMENT POLICIES (explain and evaluate)

- The Department of Trade and Industries has various programmes in place to support SMMEs.
- The creation of employment for structurally unemployed people
- Focus is on incentives for small businesses
- providing easier access to capital, information, business advice and
- promotion of entrepreneurial development among women and the youth

THE APPROPRIATENESS OF BLACK ECONOMIC EMPOWERMENT IN THE SOUTH AFRICAN ECONOMY

- This strategy is in line with the empowerment of marginalised groups towards development in developing countries. It is in line with the UN and World Bank development initiative of indigenous people in a country.
- **Limitations/challenges are:** managerial appointments did not always meet the required training and experience criteria needed to make a success of the positions.
Foreign and local investors do not show trust in the industry mainly because of corruption and the expressed views of nationalisation.

PERFORMANCE INDICATORS

The performance of the economy is assessed and determined by using the tools known as **social and economic indicators**.

Economic indicators: is statistic (data) that shows the behaviour of an economic variable over a specific period of time.

- **Production** : nominal GDP, real GDP, per capita GDP
- **Inflation rate**: two keys: PPI, CPI
- **Foreign trade**: terms of trade, exchange rate,
- **Employment** : EAP, employment rate, unemployment rate
- **Productivity**: labour productivity, remuneration per worker • **Interest rates**: repo rate

- **Money supply:** the level of money supply in the economy is important because any change in its quantity will have a direct effect on interest rates.

Social indicators: also called human development/development indicators because they promote improvements in the standard of living.

- **Demographics:** population growth, life expectancy
- **Health and nutrition:** Health (infant mortality, life expectancy, health expenditure, access to healthy water, access to sanitation); Nutrition (process of providing or obtaining the food necessary for health and growth)
- **Education:** literacy, knowledge, skills (effective and appropriate)
- **Services:** energy, sanitation, refuse removal and water access and use, access to food
- **Housing and urbanisation:** Housing (housing subsidies, housing loans);
- **Urbanisation** (natural growth of urban population, migration, establishment of new towns)

Activities:

Activity 1

1.1. Study the cartoon below and answer questions that follow.



- 1.1.1. Mention one country that is found in the North. (1)
- 1.1.2. Give an alternative term for countries in the South. (1)
- 1.1.3. Describe the term *sustainable development*. (2)
- 1.1.4. Briefly explain *unequal standard of living* as a characteristic of North and

- South divide (2)
- 1.1.5. Evaluate the impact of globalisation on developing countries. (4)
- 1.2. Why is it important for the government to assess the performance of the economy? (8)
- 1.3. How can developing countries ensure the survival of labour intensive industries in a global economy? (8)

Activity 2

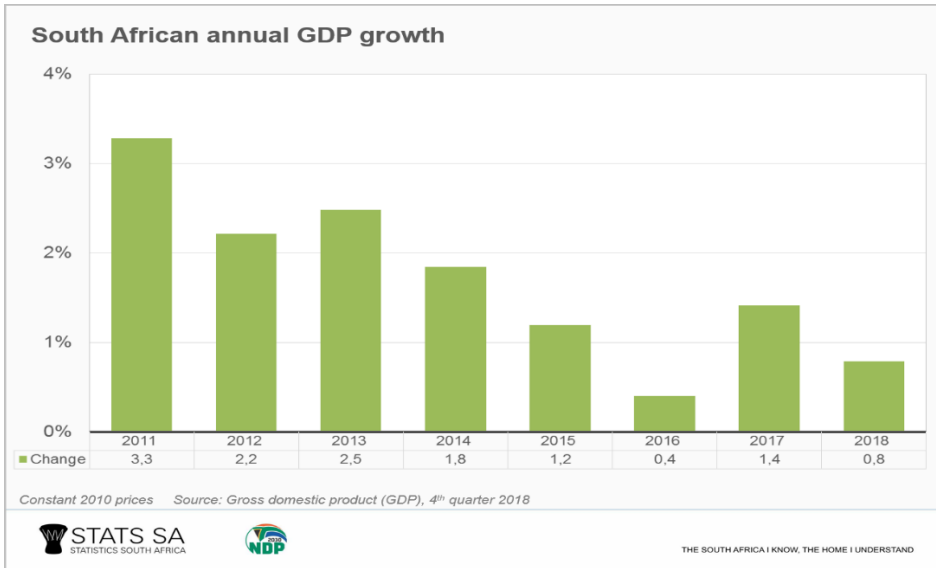
- 2.1. Study the diagram below and answer question.



- 2.1.1. Identify ONE aim of the National Development Plan from the above diagram. (1)
- 2.1.2. In which year are National Development Plan objectives expected to have been achieved? (1)
- 2.1.3. Describe the term *industrial development*. (2)
- 2.1.4. Briefly explain critical infrastructure programme (CIP) as an incentive to improve industrial development. (2)
- 2.1.5. Evaluate success of BBBEE as a strategy for growth and development. (4)
- 2.2. Discuss how indigenous knowledge systems (IKS) can be used to eradicate poverty in South Africa. (8)
- 2.3. How can South Africa benefit from regional development? (8)

Activity 3

3.1. Study the graph below and answer questions that follow:



3.1.1. Which economic indicator is depicted by the graph above? (1)

3.1.2. In which year was GDP at its lowest? (1)

3.1.3. Describe the term *demographic cycle*. (2)

3.1.4. Briefly explain how South Africa can secure sufficient water supplies in the country. (2)

3.1.5. How would the National Health Insurance (NHI) positively impact on the life of South African population? (4)

3.2. Why is the development of new industries important to the economy? (8)

3.3. Evaluate the impact of a downgrading of South Africa's credit ratings on the economy? (8)

CONTEMPORARY ISSUES

INFLATION

Key concepts

Administered prices inflation: Price that are set and controlled by the government.

Bracket creep: the movement of income tax payers into higher tax brackets as a consequence of an interest in money incomes with income bands for each rate of tax remaining the same.

Consumer price index: an index that measures the price of the fixed basket of consumer goods and services

Core inflation; Excludes items from the CPI basket that are highly volatile or prices affected by government policy.

Cost-push inflation: occurs when there is an increase in the cost of production.

Deflation; It a general decrease in price level

Demand-pull inflation: Occurs when the aggregate demand for goods and services exceeds the aggregate supply of goods and services.

Government bond: paper issued by the government in exchange for a loan which redeemable at some future date in long term

Headline inflation: it an unadjusted CPI figures

Hyper inflation:An inflation rate that is above 50% .People lose confidence in the value of money and start bartering goods and services

Implicit GDP deflator: the behavior of prices of all final goods and services produced in a particular year, and not only a selected basket of goods and services .it is calculated by comparing a GDP at current price with the GDP at constant price

Index: a measure designed to show average changes in the price, quantity or value of a group of an item over a period of time

Inflation: A sustainable and significant increase in general level over a period of time.

Inflation target: Form part of monetary and is managed by the Reserve Bank to keep inflation within the range as set by the minister of finance (between 3% -6%

Monetary Policy Committee (MPC): Consist of the government of reserve bank ,3 Deputy governors and another 3 members .Their main purpose is to determine an interest rate that will be consistent with meeting the inflation target.

Price index: includes the prices of a representative sample of goods and services.

Production price index: measures the price at the level of the first significant commercial transaction (when they are leaving the factory gate)

Stagflation: Low growth, high unemployment and high inflation rates occurs simultaneously.

Weighted index. An index number in which the component items are weighted according to some system of weights reflecting their relative importance

INFLATION

Definition

➤ Inflation is a sustained and significant increase in the general price level over a period of time.

Measuring inflation

- Changes in the price level are measured by means of price indexes.
- An index shows average changes in the price, quantity or value of a group of items over a period of time.

➤ Indexes

- The average price level in the economy is measured in the form of an index number – a price index.
- Calculating a price index is a complicated process. Prices of a representative range of goods and services need to be recorded on a regular basis.

➤ Weighting

- To overcome the problem of differences in the importance of items in an index, and different units of measurement, a weighted index number makes the figures directly comparable.
- The weight reflects the relative importance of an item. If food is given a weight of 30% and housing a weight of 15% it means that a change in the price of food is twice as important as a change in the price of housing.
- Given a system of weighting, an index number can be calculated by the price relative method.

➤ Inflation rate

- The inflation rate can be calculated once the consumer price index figures have been set.
- Inflation is always expressed as an annual rate.
- The most common practice is to compare the index for a particular month with the index of the corresponding month in the previous year, for instance, on a year to year (y/y) basis. The result is then expressed as a percentage increase.

- For example, $\frac{\text{Total index for February 2017}}{\text{Total index for February 2018}} \times 100$

Total index for February 2018 1

Types of inflation

a) Consumer inflation

i) Headline inflation

- Consumer's inflation is measured by the Consumer Price Index (CPI).
- It represents the cost of the "shopping basket" of goods and services of a typical or average South African household.
- The CPI inflation rate is also known as headline inflation.

ii) Core inflation

- Core inflation excludes items from the CPI basket that have highly volatile prices (prices which go up and down rapidly), and items with prices that are affected by government intervention and policy.
- These items include food, petrol and electricity. It is compiled from the detail provided by the surveys of the CPI.

iii) Administered prices inflation

- Administered prices are the prices of goods and services that are set by government or controlled by government appointed authorities such as assessment rates and property taxes, price of fuels, electricity, telephone line rentals, television and radio licences, vehicle registrations, etc.

iv) CPIX inflation

- The CPIX inflation is calculated by using the CPI, but excluding mortgage interest rates from the basket.
-

b) Producer's inflation

- Another kind of inflation is measured by the production price index (PPI).
- The PPI measures prices at the level of the first significant commercial transaction.

The differences between CPI and PPI:

Consumer price index (CPI)	Production price index (PPI)
• Pertains to cost of living	• Pertains to cost of Production
• Basket consists of consumer goods and services.	• Basket consists of goods only, not services.
• Capital and intermediate goods are excluded.	• Capital and intermediate goods are included.
• Prices include VAT.	• Prices exclude VAT.
• Interest rates are taken into consideration.	• Interest rates are excluded.
• Prices of imported goods are not shown explicitly	• Prices of imported goods are shown explicitly.

c) All-inclusive inflation

- Economists often need to check the changes to the prices of all final goods and services produced in a particular year, and not only a selected basket of goods and services.
- To find this they calculate an implicit GDP deflator.

Year	GDP at current prices (R billion)	GDP at constant prices (R billion)	GDP deflator (2005 = 100)	Inflation (%)
2015	3 625 714	2 786 739	130	7,2
2016	3 880 824	2 805 240	138	8,2
2017	4 171 729	2 842 416	146	7,6

(source :Quarterly bulletin December 2018)

- GDP deflator is merely an index number. This is because of the effect that constant prices of the base year exercise.
- To calculate the inflation rate the same procedure as for the CPI inflation rate calculations is used.
- GDP deflator for 2015 = 130
- GDP deflator for 2016 = 138

$$\text{Inflation rate for 2017} = \frac{146 - 138}{138} \times 100$$

$$= \frac{8}{138} \times 100$$

$$= 5,7$$

- The implicit GDP deflator gives an inflation rate for the economy as a whole.
- An alternative method of calculating inflation:

$$\frac{\text{GDP deflator for 2017}}{\text{GDP deflator for 2016}} \times 100 = \frac{146}{138} \times 100$$

$$= \frac{105,7}{100} = 105,7\%$$

$$105,7\% / 100 = 5,7\%$$

d) Hyperinflation

- Hyperinflation occurs when there is an extremely rapid increase in the general price levels. The money becomes worth almost nothing.

e) Stagflation

- Stagflation refers to a condition of stagnation of economic growth (low growth and high unemployment) and high rates of inflation.

f) Deflation

- Deflation indicates a continuous decrease in the general price level. Deflation is accompanied by high unemployment and low prices.

CAUSES OF INFLATION

a) Demand-pull inflation

Demand-pull inflation takes place when the prices of goods and services increase when the aggregate demand is higher than the aggregate supply.

Causes of Demand-Pull Inflation

i) **Consumer spending (C)**. The disposable income of households can increase at a faster rate than aggregate supply for three reasons:



- **Less savings**. If consumers change their savings habits and start spending their current and accumulated savings, growth in aggregate demand can outstrip growth in aggregate supply.
- **Reduction in taxes**. This applies more to personal income tax than indirect tax. Consumers have more disposable income if direct tax is decreased by the government. This will increase consumer spending.
- **Access to credit**. The greater the availability of consumer credit (e.g. credit cards) or availability of cheaper credit as a result of a decrease in interest rates.

ii) **Investment spending (I)**.

Lower interest rates may result in an improvement in the sentiment and profit

expectations of businesses. Businesses invest more and this may lead to an increase in the demand for goods and services that are part of investment (e.g. new buildings require cement, bricks and labour). If aggregate demand increases at a faster rate than aggregate supply, price increase will follow.

iii) **Government spending (G)**. An increase in government spending without a corresponding rise in aggregate supply, leads to an increase in price hence inflation.

- iv) **Export earnings (X).** Increase in export earnings from exports can come from various sources, namely:
- **Foreign growth.** Growth of the economies of trading partner countries may create a demand for a variety of locally produced goods. The sales of exports bring money into the country. Demand increases without a corresponding increase in supply, resulting in an increase in prices.
 - **Commodities demand.** The world's demand for commodities expands and contracts like business cycles do. During an expansionary period, foreign demand increases, and this leads to greater volumes of exports. The income earned from these exports adds to aggregate demand, and prices increase.

b) COST-PUSH INFLATION: Cost-push inflation is a general increase in prices caused by increase in factor costs. In order to stay in business, producers are compelled to pass these higher production costs on to consumers in the form of higher prices.

Causes of cost-push inflation are as follows:

- **Increase in wages and salaries.** If trade unions are successful in negotiating better wages, the wages will go up. The producers will increase the selling price to compensate for the higher input costs.
- **Price increase of imports.** The price of the imported goods may rise because of the depreciation of the local currency against the currency of the country which we import from. The producers have to pay more for the importing of goods and therefore they will increase the prices of the local products that they produce.
- **Increase in profit margins.** If the producers decide to raise their profit margins, then the cost of production will increase and the products will be more expensive.
- **Decrease of productivity.** If the productivity decreases while the remuneration of the factors of production stays the same, the unit cost will increase.
- **Natural disasters.** Natural disasters such as floods, droughts and extreme weather will have an impact on the costs of production. The prices of agricultural products will increase in times of disaster.
- **Exchange rate depreciation.** If the rand depreciates in terms of the US dollar, all imported goods and services become more expensive.
- **Strikes and stay-aways** which reduce production output and cause a drop in the supply.
- **An increase in administered prices** may result in trade unions demanding higher wages. Producers may simply add the increase to the price of the final product.
- **An increase in indirect tax** such as VAT and custom duties will be added to the selling price and contribute to inflation.
- **An increase in direct tax** may lead producers to increase prices to offset their extra burdens.
 - **The high cost of inputs in the agricultural** sector such as diesel and fertilisers are added to the price of products.
- **An increase in interest rates** means businesses will pay more for loans. This increase may also be added to the selling price

4 Consequences of Inflation

Inflation means gains to some and losses to others. The following are the consequences of inflation:

- a) **Creditors and debtors.** Whereas borrowers (debtors) benefit from price increases, lenders (creditors) suffer due to price increases. This is because borrowers receive money with a relatively high purchasing power, and they repay their loans with money with low purchasing power unless interest rates are sufficient to prevent this.
- b) **Salary and wage earners/Redistribution of income.** Prices increases affect people whose incomes are relatively fixed. This group includes retired people, pensioners and the poor.
- c) **Investors and savers/a decline in real savings.** Different types of investments are affected differently by inflation:
 - **Assets with fixed nominal values.** Because their nominal values remain constant, the purchasing power of the nominal values decreases as prices increase, that is, their real value decreases.
 - **Assets with flexible market values.** The holders of shares and fixed property usually gain by price increases because the nominal values of these assets tend to increase at least proportionately to the rate of inflation.
- d) **Taxpayers.** With inflation, the taxpayers' nominal incomes (wages and salaries) rise even when their real incomes remain unchanged. Individuals will have to pay higher taxes even if they are actually no better off than before.
- e) **Industrial peace.** Wage bargaining is often accompanied by strikes and mass action. These actions can sometimes spill over into violence, which affects society at large.
- f) **Buying power of money decreased.** The consumers can buy fewer goods and services with the same amount of money because of the price increases.
- g) **Government income.** Price increases lead to an increase in wages and salaries which mean that direct taxation will also increase. The government will receive extra income from the taxpayers.
- h) **Unemployment and poverty increase.** Due to an increase in prices which may result in less demand and less supply. The suppliers have to retrench some of the workers. As a result, unemployment and poverty will increase.
- i) **Inflation has an adverse effect on the country's balance of payments.** Inflation causes domestic prices to increase and this makes domestic exports uncompetitive on the international market and South African exporters may lose majority trading partners.
- j) **Inflation impacts negatively on economic growth.** Uncertainty discourages savings and investments and cumulative effect has a negative influence on the rate of growth.
- k) **A high rate of inflation is harmful to the workings of a system of free enterprise.** In the long run, inflation is harmful to free enterprise as it distorts prices of goods and services.

INFLATION IN SOUTH AFRICA a) Historical overview

Inflation was relatively low until the early 1970s, averaging 2,5% during the 1960s, according to the table below:

Year	1960s	1970s	1980s	1990s	2000-10	2010-18
CPI	2.5	10.3	14.8	8.7	6.0	4.8

Table 1: Inflation in South Africa

- During the 1970s it averaged 10.3, and then in the 1980s it peaked at about 14.8%.
- The highest annual rate during this period was 18,6% in 1986, and the lowest was 10.9% in 1987.
- Such a sustained period of double-digit inflation had never been experienced before in South Africa.
- Inflation subsided significantly in the early 1990s. It subsequently decreased further to 6.0% in the 2000 and now at average of 4,8 from 2010 to 2018. In 2019 it averaged at 4.38%

MEASURES TO COMBAT INFLATION**Combating demand-pull inflation****Monetary policy**

- The monetary authorities (the MPC of the Reserve Bank) can increase interest rates and reduce the money supply.
- This raises the cost of credit and reduces the availability of credit to the various sectors of the economy.
- **Increased savings.** An increase in interest rate may motivate people to save, because they will get higher interest on their savings
- Various instruments can be used to accomplish this, namely, **increasing the bank rate (repo rate) and encouraging savings.**
- The monetary authorities can apply moral pressure on financial institutions to be more careful when granting credit.
- The monetary authorities can relax **exchange controls** as a measure to combat inflation.
- Inflation targeting: in South Africa the inflation target is 3% - 6%.

Fiscal policy

- The Minister of finance uses policies **of taxation and expenditure** to control inflation
- This reduces the demand for goods but also has a negative effect on employment and production
- Indirect taxation such as VAT, or customs and excise duties can be increased
- An increase in direct taxation which will decrease disposable income and spending.
- A decrease in government spending which will lead to less money being injected into the circular flow which should lead to a decrease in demand.
- Imposing a surcharge (increases imported goods prices) on imported goods can help to control inflation
- Protection measures may also be taken to protect local industries against unfair foreign competition
- A reduction in direct tax can encourage productivity.
- A reduction on Companies tax. Less Company tax will encourage investment and capital growth which will lead to higher productivity.
- A reduction on taxes on interests and dividends which will encourage savings.



2. Combating cost-push inflation (Supply-side policy)

➤ To avoid cost-push inflation two indirect policy approaches are used:

- **Productivity.** Increases in factor productivity are most viable option. Wage increases need to be accompanied by productivity increases. Improvements in technology can play an important role.
- **Competition.** The best method for keeping a check on profit margins is to ensure competition – domestically from abroad.
- **Wage policies.** Increases in wages and salaries must be in line with the increase in productivity.

3. Other measures

- Price control is regarded as a direct method to combat inflation.
- Stricter conditions for consumer credit can restrict excessive demand such as the introduction of the National Credit Act.
- Encouraging personal savings.
- A floating exchange rate for the country's monetary unit.

- Applying the principle of indexation (automatically adjusting prices to the inflation).
- Increasing of the commercial banks cash reserve that banks have to keep at the Reserve Bank.

Inflation Targets

- The main mandate of the South African Reserve bank is to stabilise prices.
- In South Africa inflation targeting was adopted as a strategy in 2000 to deal with inflation.
- The corner stone of this policy is setting a target for inflation and then using monetary policy to reach this target.
- In South Africa this target is set between 3% and 6%.
- The Monetary Policy Committee (Minister of Finance and Governor of the Reserve Bank are members) make public announcement about the target and time frame for achieving it.
- In South Africa **repo rate** is an instrument used to control inflation **Repo rate** is the interest rate that commercial banks pay to borrow money from the Reserve Bank.
- The decision to change the repo rate is undertaken by the Monetary Policy Committee after considering a wide range of variables.
- Decision and factors that influenced the change are communicated to the public every two months.
- The South Africa Reserve bank is accountable to parliament for achieving goals.



TOURISM

Definition of the term tourism: tourism is the activities of people travelling to and staying in places outside their usual environment for no more than one consecutive year for leisure, business and other purposes not related to an activity remunerated from within the place visited.

This general description of tourism suggests three important dimensions:

- Tourism arises out of movement of people, and their stay in various places or at destinations.
- There are two elements in tourism, for instance, the journey to the destination and the stay, including activities of the destination.
- Both the journey and the stay take place outside the usual environment or normal place of residence.

Purposes of tourism

- Tourists travel for various reasons. The most basic international classification includes the following three purposes:
 - **Leisure and recreation** e.g. enjoying a holiday, doing sports or visiting friends and family. Two terms have become popular in this category:

- **Cultural** tourism: this includes visiting museums, art galleries, archaeological sites, architectural attractions such as churches, mosques and cathedrals and other buildings and structures, attending festivals, sports events and cultural events such as religious events, pilgrimages, folklore and dancing.
- **Ecotourism**: this includes visiting natural areas, wilderness areas, visiting scenic attractions, flora and fauna, enjoying the climate, sunshine, the sea, a river or a lake.
- **Business and professional**: this include attending meetings and conferences, participating in missions e.g. to investigate housing in area, incentive visits such as travel agents that are invited to visit and experience a resort, visiting factories and other businesses for learning and information.
- **Other**: includes, among others, studying, attending to family business and receiving medical treatment.

The supply-side tourism

- The supply-side of tourism consists of all those enterprises, organisations and facilities that serve the specific wants and preferences of tourists. Most of them are in the service industry. They include the following:
- Hotels, guest houses, bed and breakfast, accommodation, restaurants, camping sites, resort residences, recreational facilities and casinos. Retailers selling travel accessories, souvenir vendors, chemists, printers and craft traders.
- Hotel schools, tourism education programmes, tourist instructors, recreation and game and nature park services, game farms.
- Tour guides, travel agents, information centres, game rangers, housekeepers and food and beverage distributors.
- Car hire businesses, transport services (taxis, buses, trains, airlines and shuttle services).

Reasons for tourism Growth

- An increase in disposable income.
- A reduction in working hours.
- More awareness of leisure and recreation.
- Improved transport, communication and accommodation facilities.

- Increases in advertising and promotion
- Awareness of the benefits of holidays and travel.
- Ease of obtaining foreign exchange and making payments
- Increase in economic activities.
- Big events such as local and international sport events, religious purposes such as the annual pilgrimage to Zion city.
- Increased migration

Growth in foreign arrivals

Foreign tourism to South Africa has grown at a high rate for three reasons:

- The peaceful transition to a democratic South Africa has impressed the world, and many foreigners want to see it (political change)
- South Africa offers the “world in one country”. People want to experience the South African diversity
- Due to the depreciation of the rand against major currencies, South Africa is regarded as a relatively cheap and good value for money destination.



The Effects of Tourism Growth

Gross Domestic Profit (GDP)

- Tourism impacts more on the services industry than on agriculture or manufacturing.
- Travel and Tourism contributes both directly and indirectly to the GDP.
- **The direct contribution** of travel and tourism reflects the internal spending of travel and tourism by residents and non-residents for business and leisure purposes as well as industries' direct spending on accommodation, food, retail, transport and destination services, and the public sector's spending directly linked to visitors, such as cultural or recreational services.
- **The indirect contribution includes:**
 - Travel and tourism investment spending by government and the private sector such as the purchase of new aircraft and construction of new hotels, resort area, water and sanitation services, etc.

- Purchases from suppliers of goods and services by the sectors dealing directly with tourists – including purchases of cleaning services by hotels, or fuel and catering services by airlines and IT services by travel agents.

Employment

- Tourism has a major effect on employment.
- Directly and indirectly, 9% of South Africa's employed people were in the tourism industry.
- Tourism sector is a large generator of jobs for the following reasons:
- **Tourism is labour intensive.** It has the lowest rate of investment to employment creation.
- **Tourism employs many skills.** There is room for almost any skill in the tourist industry such as accountants, hairdressers, tour guides etc.
- **Tourism can provide immediate employment.** If it is properly organised and focused the tourism sector can create many jobs within a short period of time.
- **Tourism provides entrepreneurial opportunities.** The tourism industry accommodates informal sector enterprises, from craft and fruit vendors to pavement vendors, chair rentals and others.

Poverty

- Tourism brings development to the poor in rural areas.
- Tourism offers opportunities to diversify sources of income for poor people:
 - **Allowing them a stake:** for example, to start and operate small-scale tourism businesses around community assets and to establish SMMEs to provide services.
 - **Empowering them:** for example, to exploit opportunities of on-the-job and other training.
 - **Creating partnerships:** linking up with mainstream tourism businesses supplying goods and services.

Externalities

- The rapidly expanding tourism industry could have both positive and negative impacts that extend well into the future.
- While tourism attracts large amounts of revenue, it can also cause undue environmental damage that can harm the foundation on which it depends.
- Tourism uses resources and produces waste.

- It also creates environmental, social and cultural costs and benefits in the process such as:
- Degeneration of traditions and cultural values.
- Environmental damage to sites and natural settings.
- Pollution and waste are generated by tourism facilities.
- Transportation and tourist activities themselves are identified as the major cause of environmental impacts associated with tourism.

Environment

- Tourism has an impact on the environment
- Tourism activities create environmental stress. The four main categories of stressor activities are:
 - Permanent environmental restructuring (highways, airports, resorts)
 - Waste product generation such as biological and non-biological waste that damages fish production, creates health hazards, and detracts from the attractiveness of the destination.
 - Direct environmental stress caused by tourist activities: for example the destruction of coral reefs, vegetation and dunes.
 - Effects on population dynamics such as migration and increased urban densities accompanied by declining populations in other rural areas.



F. Infrastructure

- Adequate physical, economic and basic services infrastructure is essential for tourist destination areas, which means they require investment in:
 - Transport infrastructure including roads (including streets and pavements), railway lines, airports ports and car parks.
 - Communication infrastructure such as telephone lines, electronic signal stations, computer connection capacity, radio, television and print media.
 - Energy infrastructure e.g. electricity and liquid fuels. Eskom should add capacity at all times.
 - Basic Services e.g. clean water refuse removal, sewage systems and storm water removal

Benefits of Tourism

- South Africa benefits directly from tourism because of the growth it brings to GDP, employment, infrastructure development and exposure to foreigners.

Households

Households benefit through three main impacts of prosperity:

- Earning an **income** directly from the tourism industry. Spending by tourists means income to households because of salaries and wages they earn through employment or through their own endeavour in the tourism industry.
- Improved **infrastructure** for tourists, but can be used by the local people e.g. Soccer City (FNB Stadium), hotels, roads, water supply and electricity etc.
- **Skills**: tourism requires a variety of skills, for which education and training are needed

Businesses

- Economic and basic services infrastructure is usually provided by the public sector, which is the case in South Africa.
- This is used as a foundation for a superstructure.
- In tourism such a superstructure consists of businesses that provide accommodation, transport, built attractions, retailing and recreational services. 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 are used to develop destinations. In South Africa a PPP is the corporate form for this.
- The public sector also provides a range of financial incentives for private sector tourism investment (grants, subsidies, loans, tax rebates, etc.).
- Apart from the traditional opportunities in the formal sector, there are many informal and less traditional opportunities. These serve as stepping stones for previously neglected groups in the tourism business:
 - Entertainment, laundry and transportation services.
 - Car rental, craft and curios sales.
 - Walking tour guides and tour of scenic places.
 - Teaching of African languages, customs and traditions.

- Eating places that emphasised local cuisine and guest houses.
- Beach massages, manicures, pedicures and chairs and umbrellas for hire.

Government

- The main avenue for the government to benefit from tourism is through the levying of taxes.
- It is customary for governments to levy specific taxes on the tourism sector. Such taxes have two purposes:
 - To recover external costs.
 - To raise revenue.
- The most common forms of raising public income from tourism are airport departure taxes, air ticket taxes and taxes on hotel room occupancy as well as casinos.
- Foreign tourists who visit South Africa also pay all the normal expenditure taxes, such as VAT, excise duties and custom duties. However, on their departure from the country tourists can reclaim the VAT that they have paid.



Infrastructure developments

- Adequate and well-maintained physical and basic services infrastructure are essential for tourist destinations. These are normally shared by residents and visitors alike.
- The government has prioritised economic infrastructure, including elements such as ports, beaches, rivers and lake access, to support tourism growth.
- Most economic corridors have tourism as an important focus.
- The PPPs are sometimes used for the development of infrastructure.
- In addition to physical and basic services infrastructure, tourists as well as residents, also require social infrastructure, for example, ambulance services, medicines, clinics and hospitals, police protection and information services.

South Africa's tourism profile

➤ The growth in South Africa's foreign tourism proves that South Africa is a popular tourist destination for foreigners.

a) Tourist generating countries

- South Africa provides 74% of the tourists coming to South Africa. From this some are from SADC countries.
- Tourists from outside South Africa bring the money in. For most of them South Africa is a holiday destination.
- Europe, especially the United Kingdom generates about one-third of the tourists from Europe.
- The highest growth was from countries outside Europe and Africa, particularly from the United Nations, Australia and Asia.

b) Purposes for travelling

- Foreign tourists visit South Africa for the purposes of vacation and business.
- Domestic and international tourists alike spend much of their time and money on three key attractions: the coast, wildlife and the country's varied scenery of mountains, deserts and bushveld.



c) Destinations

- Destination brings together all aspects of tourism, including demand, transportation, accommodation, supply and marketing.
- Destinations and their images attract tourists, motivate the visit and therefore energise the whole tourism system.
- The geographical distribution of tourists in South Africa is uneven.
- Some 55% of inbound tourists prefer Gauteng and the Western Cape as destinations.

d) Domestic tourists

- Domestic tourists undertook a total of 26,4 million domestic trips in 2011. However the number of adult South Africans who travelled domestically grew to 13,9 million.
- In 2011, the average amount spent per domestic trip grew to R780 per trip. More South Africans are travelling for leisure.

e) Indigenous Knowledge Systems (IKS)

- This refers to local knowledge or the local way of doing things. Tourists want to experience how local people live and work.
- Tourists are no longer satisfied with passive experience.
- Instead they seek authenticity and uniqueness at destinations.
- They want to understand the indigenous culture, history and environment.
- Of significant importance, in this regard, are our World Heritage Sites. Examples are:
 - Mapungubwe
 - The Vredefort Dome
 - The Sterkfontein caves
 - Robben Island
 - Richtersveld Cultural and Botanical Landscape
- Our environmental World Heritage Sites represent the extreme of our indigenous environmental uniqueness. We have three such sites:
 - iSimangaliso Wetland Park, formerly known as the Greater St Lucia Wetland Park.
 - The Cape Fynbos Region, including the Table Mountain and the Agulhas National Park.
 - uKhahlamba Drakensberg Park including almost the entire Drakensberg mountain range.

Policy Suggestions

Policies to promote Tourism

1. Marketing

- The marketing and promotion of South Africa's tourism has both an international and a local dimension.
- South African tourist attractions can gain from the promotion of South Africa abroad as a possible tourist destination.

- Similarly, tourist attractions in all the provinces can gain by promoting the advantages of tourism in South Africa at large.
- In an international context, generic marketing endeavors to have South Africa included as a tourist attraction when the tourist consider their itinerary or when travel agents presents their clients with options.
- than one holiday a year, to consider the wide variety of destinations, and to try group tours.

South African tourism promotes the following initiatives:

a) Welcome campaign

- This campaign was launched in 2004 at the Tourism Indaba and it encourages all South Africans to make every tourist feel at home. If tourists are made to feel welcome, they are more likely to return for repeat visit and to tell others about their experience.

b) Welcome Awards

- The Welcome Awards recognises those businesses and individuals that improve the quality of tourist offerings. The awards recognises high standards and excellent service.

c) Sho't Left Campaign

- This campaign is aimed at making travel more accessible and affordable for all South Africans. d)

Tourism Indaba

- The annual Tourism Indaba is one of the largest marketing events on the African calendar. It showcases a wide variety of the best tourism products in Southern Africa and attracts visitors and media from across the world.
- The Tourism Indaba promotes destinations, attractions, tour and events to tourism companies, tour operators, developers and private individuals.

e) Tourism Enterprise Partnership

- Tourism Enterprise Partnership's objective is to improve the sustainability of small tourism enterprises to protect and promote job-creation and transformation within the tourism industry.

2. Directing/Spatial distribution

- Tourist flows should be redistributed to poorer areas where tourists do not usually go, since most tourists flock to the same familiar destinations because the attractions at those destinations are well known.
- To redistribute tourist flows, three approaches can be followed:

- Creating representative bodies (with stakeholders from less familiar areas) to lobby the wider tourism industry to promote their areas.
- Improving marketing to highlight benefits and attraction of these areas. Owners or representative bodies can check their past endeavors to promote their attractions, in terms of the four “Ps” of marketing (Product, price, promotion and place).
- Improving and extending supporting services. The cause of the uneven distribution of tourism may not be in the attractions themselves but due to the supporting services such as accommodation, services (e.g. retailing, safe parking, security, bank card payment, hairdressers etc.), access to the attractions destinations (efficient transport, dirt and gravel roads etc.) and ancillary services.

3. Taxing

➤ The World Travel And Tourism Council (**WTTC**) condones the levying of taxes on the tourist industry, within the following guidelines:

- **Equity:** requires taxes to be fair and that the tourist industry be treated equally to the other sectors of the economy.
- **Efficiency:** this means that the tax should not affect the tourism demand, unless specifically imposed to restrict access.
- **Simplicity:** the taxes should not disrupt the operations of the tourism industry and should be simple to pay and administer.



4. Infrastructure development

- The economic and basic services infrastructure must be maintained to sustain all economic activity and not just tourism
- The accessibility and Infrastructure of rural areas should be improved. If secondary roads (gravel and dirt roads) are properly maintained, domestic tourism will increase because most South Africans have a rural background and love to travel into the rural areas.

5. Develop new tourism products

- Tourism needs to be promoted in new and unusual niche markets such as wine and cuisine tourism, and adventure tourism such as horse trails, river rafting, shark cage diving and bungee jumping and also in cultural tourism.

6. Improve security and reduce negative perceptions

- Efforts have to be made to improve security, especially at tourist sites. The media need to focus on the many positive stories to boost the country’s image.

7. Attract more international events to the country

- After the success of the 2010 World Cup, South Africa is in good position to attract other, future events.
- There needs to be a policy to attract international events.

8. Promote the film and television industry

- The film industry has a huge potential to promote the country.
- Favourable conditions need to be provided for filmmakers, as these industries reach a greater tourism market audience than targeted advertising campaigns.

9. Environmental management

- Government is aware of the importance of ensuring that all aspects of the environment are managed in a responsible manner in terms of scarce resources such as land, water and forest, and especially the heritage sites.

10. Education and training

- Adequate education and training and awareness programmes are required to address deficiencies in the tourism industry in South Africa.
- These programmes need to address the shortcoming regarding the previously neglected groups in South Africa in terms of job levelling in the industry.
- The Tourism, Hospitality and Sport Education and Training Authority (THETA) is the Skills, Education and Training Authority (SETA) currently conducting planning of education and training of this sector.

ENVIRONMENTAL SUSTAINABILITY

- **Biodiversity:** the variety of plant and animal life in the world or in a particular habitat a high level of which is considered to be important and desirable
- **Conservation:** Seeks creative continuity of the environment, while ensuring that environmental change considers the quality of life for both present and future generations.
- Ecosystem:
- **Environmental sustainability:** the ability of the environment to survive its use for economic activity.
- **Green economy:** sustainable development that does not erode the environment.
- **Green taxes:** taxes on output or consumption, which are charged for the adverse effects on the environment.

- **Hazardous waste:** is a waste that poses substantial or potential threats to public health or the environment. can be liquid, solids or contain gases
- Organic food
- **Pollution:** occurs when the flow of residual emission resulting from human activity exceeds the natural environment's capacity to absorb them.
- **Preservation:** To keep resources that are non-renewable intact, e.g. ecological system heritage sites.
- **Property right:** is an exclusive authority to determine how a resources is used, whether that resource is owned by government or by individual.
- **Residual waste:** refers to the material that remains after the process of waste treatment has taken place.

Environmental Sustainability

- a) The term **environment** refers to everything around us: land, water, air, plant and animal life. It provides us with the space to live, erect buildings and produce food. The environment also provides us with the resources for the production of goods and services.
- b) **Pollution** is the contamination of the environment by a chemical or other agent that renders part of the environment unfit for its intended use. **Pollution** occurs when people introduce waste matter into the environment, both directly and indirectly.

The state of the environment



➤ Environment is under pressure because human claims on the environment are more than what nature can provide for on a long-term basis. These claims originate for the following reasons:

- Increasing population numbers.
- Excessive consumption.

The activities of humans put demands on the natural environment in two ways:

- **Inputs.** The natural environment provides the resources for the living and working activities of humans.
- **Outputs.** The living and working activities of humans produce waste that is disposed of in the environment.

Pollution

- Pollution is the introduction of waste matter into the environment, both directly and indirectly
- Production and consumption of goods and services lead to unwanted residuals

- Technology and the control of pollution have cleaner environmental effects than previous technologies e.g.

electricity produced from coal and fossil fuel energy

Types of pollution

- **Air pollution:** it occurs when there is an accumulation of substances in the atmosphere in such concentrations that they become part of the air we breathe. Air pollution can include noise pollution, tobacco smoke, exhaust fumes and acid rain. Air pollution has a negative impact on human health and harmful effect on ecosystems.
- *The causes of air pollution include the following:*
 - Chemical substances such as nitrogen oxides, carbon monoxide, fossil-fuel burning power plants.
 - Toxic substances from motor vehicles that combust fuel, chimneys and burning of wood, forest fires and the heavy industrial use of chemicals.
- **Water pollution:** this is the introduction of chemicals and physical or biological materials into fresh water. The largest sources of water pollution are the dumping of industrial waste and treated sewage into lakes and rivers, and the run-off from fertilisers. The introduction of these pollutants contaminate the water and affects organisms that live in rivers and seas. It also poses a great health hazard to people who use untreated water in rivers, dams and lakes for cooking, cleaning and drinking. Examples of water pollution are:
 - sewage disposal and domestic waste
 - Industrial effluents
 - Agricultural and mining waste
- **Land pollution/environmental pollution:** it arises from dumping toxic waste products. Land pollution damages the earth's land surface through misuse of the soil by poor agricultural practices, mineral exploitation, industrial waste dumping and the haphazard disposal of urban waste. It includes visible waste and litter as well as the pollution of the soil itself. Examples of land pollution: soil pollution, waste disposal and soil erosion.
- **Noise pollution:** people who live near airports, train stations or factories can actually be harmed by the noise levels they endure.
- **The disposal of toxic/hazardous waste:** the disposal of toxic waste, also known as hazardous waste, is particular form of land pollution and presents particular challenges in both developed and developing countries. Toxic waste is any poisonous by-product of manufacturing, farming, sewerage systems, construction sites, motor vehicle garages, laboratories and hospitals. Toxic

waste is often dumped or buried underground where it can contaminate soil and underground water supplies. **Conservation**

- Conservation deals with the sustainable use and management of both renewable and non-renewable resources to ensure that they are available for use for future generations. Conservation is necessary, since humans tend to over-utilise the environment. Conservation is applied in botanical parks, game parks, reptile and butterfly sanctuaries, minerals and forests, museums, buildings of special architectural and historical interest etc. The following aspects of conservation need to be emphasised:
 - There is an opportunity cost.
 - Externalities are often present.
 - Self-interest has a short-term horizon.

Preservation

- Preservation means to keep something intact. Preservation deals with those aspects of the environment that are threatened with extinction. Some resources are not only non-renewable but if lost, they are irreplaceable. For example, an ecological system, a heritage site, an indigenous forest, a wetland, a river mouth ecosystem, species of animals, birds, insects and flowers on the verge of extinction.

i) **Private property:** preservation is not likely to work as a private enterprise. Let's use an example of a river mouth ecosystem which is part of a farm which is a private property. It has fresh water prawns and insects on which wild birds feed. During breeding seasons, some fish species breeds here. The farmer can sell some prawns and small fish as bait and charges a fee to people using a picnic spot or a hiking trail. The benefit to the society is much bigger than the income of the farmer. Society has the pleasure of the scenery, sea fish catches, birds and unspoiled nature.

ii) **No compromise:** if all the river mouth ecosystems were to be developed e.g. into a holiday resort, the animal and plant life would be severely affected. Humans will also suffer. Some things are simply not for sale.

iii) **Government policy:** the government can interfere by doing the following:

- **Buy or expropriate.** Under government control and management, social welfare may be maximised but it may be costly. In many instances, such assets are simply closed for human use, such as indigenous forests in South Africa.
- **Subsidise.** The river mouth ecosystem could be left to private ownership but a subsidy given through maintenance grants or tax concessions.
- **Controls.** The government can compel the owner to apply control measures, such as the quantities of prawns and young fish that may be removed, the activities of visitors and the number of visitors allowed per day.

Externalities

- Externalities are the extra costs and benefits that are not captured by market transactions. They can either be positive or negative. This depends on whether people enjoy additional benefits that they did not pay for, or whether they suffer additional costs that they did not originally incur. An example of a negative externality could be pollution emitted from a factory affecting the health of residents in close proximity to the factory. An example of a positive externality could be the invention of new technology such as solar power being used in production processes.
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- **Controls.** The government can compel the owner to apply control measures, such as the quantities of prawns and young fish that may be removed, the activities of visitors and the number of visitors allowed per day.
- The term **environmental sustainability** means the ability of the environment to survive its use for economic activity.
- The fact that current levels of pollution and environmental degradation are too high means that pure free market has failed to provide an optimal utilisation of the environment.
- Beyond the market, two options are possible:
 - Government intervenes and then allows market forces to operate and produce an outcome.
 - Government takes control and ensures, by means of laws, that the desired outcomes are realised.

A. Using the market

➤ The market can be used to ensure sustainability, provided sustainability is to the advantage of producers.

Therefore, a particular approach is required.

i) The market does not capture social costs and benefits. The market is driven by self-interest. This implies that the environment is for individuals to use for their own benefit. ii) The market fails for various reasons:

- **The environment is a common resource:** Many parts of the environment are not privately owned, such as the seas. Many of the services provided by the environment do not have a price, so there is no economic incentive to economise on their use. At a zero price the environment will be overused.
- **Externalities:** When people pollute the environment, the costs are borne by others. The greater these external costs, the lower the socially efficient level of output will be. If a business pollutes the air that we breathe, no one can stop it because the air belongs to no one.
- **Lack of knowledge:** People may cause environmental damage without realising it, especially when the effects build up over a long time.
- **Carelessness:** Consumers and businesses are frequently prepared to continue with various harmful practices and leave future generations to worry about their environmental consequences.



iii) The mechanism of the market and social costs and benefits. If pure market forces fail to produce the desired result of sustaining the environment, it means that the market has failed. It failed because it did not capture in the market price all the costs and benefits that result from human production activities, and therefore the quantities that were produced and consumed were inappropriate.

B. Public sector intervention

○ Policies include **granting property rights** people care for the things that belong to them and will try and use them as profitably for as long as possible. If property rights can be expanded to common goods such as clean air, those suffering from pollution can charge the polluters for the right to pollute. The principle of the polluters paying victims to reduce pollution is sometimes followed by government e.g. in terms of the **Kyoto Protocol**, the 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.

○ **Environmental subsidies:** an alternative is to provide subsidies for activities that reduce environmental damage. For example, recycling of waste, production of unleaded petrol, development of an equipment to save energy or to reduce smoke etc.

○ **Charging for the use of the environment:** the pricing of the environment is one method used by the government to impose environmental charges. This means that government levies a fee on consumers and producers for the waste (solid, liquid and gas) they produce and dump in the environment. For example, local authorities levy charges for rubbish collection or sewage disposal on households, businesses and others.

○ **Levying environmental taxes/green taxes:** a tax can be imposed on the output of a good, wherever external environmental costs are generated. Green taxes are charged on items such as tyres.

Marketable permits: each business is given a license (permit) to emit a share of the chemical pollutants. In developed countries the business who obtain these licenses or permits or credits, can trade them in a permit market.

C. Public sector Control

○ **Command and control (CAC)** measures entail the setting of maximum permitted levels of, (e.g.) emission (carbon dioxide), or resource use (tons of fish) or minimum acceptable levels of environmental quality (in plantations). There are three approaches to devising CAC systems:



- **Quantity standards:** these methods focus on amounts or quantities of pollution caused, irrespective of the environmental impact, for example motorcar gas emissions. As technology for reducing pollutants improves, so tougher standards could be imposed, based on the best available technology.
- **Quality standards:** these methods focus on the environment impact. For example, standards are set for air and water purity. In South Africa municipalities can qualify for blue drop status on account of the purity of the tap water.
- **Social impact standards:** here the focus is on people. For example, tougher standards for noise levels are imposed in densely populated areas than in rural areas.

○ **Education** plays a major role in improving people's capacity to manage the environment. Pressure groups such as the Green Party and Friends of the Earth have forced industries to encourage managers to integrate environmental responsibility into all their business decision making. Education plays a major role in improving people's capacity to manage the environment.

○ **Voluntary agreements** rather than imposing laws and regulations, the government can seek to enter into voluntary agreements with businesses for them to cut pollution. Such agreement may involve a formal contract which would therefore be legally binding, or they may be more informal commitments.

D. International measures

○ Many of the environmental problems are not only local or national but are global. Global issues require joint action by the governments around the world. The world's biggest concerns are loss of biodiversity, toxic and hazardous wastes and climate warming.

Since as early as 1972, a number of international events have been organised to address the issues of sustainable development and the impact of global practices on the future of our natural resources. Many decisions have been made at these conferences in order to provide guidelines to the developing countries of the world.

Activity 4

4.1. Study the extract below and answer questions that follow.

Coronavirus: how will a drop in Chinese tourists' numbers affect Cape Town tourism

Cape Talks asks a Cape Town Tourism CEO, how big of an effect this coronavirus will have on the local tourism season. The CEO points out that tourists from China (14 000 in 2019) make up 1% of tourist arrivals in the mother city.

He acknowledges that despite representing a small (but growing) size of the pie, a drop in Chinese visitors will still make a difference.



- 4.1.1. What is the contribution of Chinese visits to Cape Town? (1)
- 4.1.2. Mention a strategy that is used by South African Tourism (SAT) to market South Africa. (1)
- 4.1.3. Describe the term *transit tourist*. (2)
- 4.1.4. Briefly explain how the tourism industry contributes to employment. (2)
- 4.1.5. How would the South African tourism industry continue to attract tourists during this era of the outbreak of the coronavirus? (4)

Activity 5

5.1. Study the cartoon below and answer questions that follow.



As the years progress the buying power of money declines. That is why salaries of workers should be adjusted at an inflation rate.

- 5.1.1. What is the inflation targeting rate in South Africa? (1)
- 5.1.2. Which institution is responsible for monitoring inflation ? (1)
- 5.1.3. Describe the term *hyperinflation*. (2)
- 5.1.4. Explain the impact if inflation on the balance of payment. (2)
- 5.1.5. How does a low inflation rate benefits producers? (4)
- 5.2. Discuss the possible effects of the Fourth Industrial Revolution (4IR) on tourism industry. (8)
- 5.3. How successful has South Africa been in using education to ensure environmental sustainability? (8)

Activity 6

Discuss in detail the appropriateness of South Africa's regional development policies in terms of international benchmark criteria. (26)

How successful has South African government been in meeting the aims of regional development? (10)