Ministerial foreword

The Department of Basic Education has pleasure in releasing the series called *Mind the Gap* study guides for Grade 12 learners. The first subjects in the series include Life Sciences, Accounting, Economics and Geography. These study guides are another innovative and committed attempt by the Department of Basic Education to improve the academic performance of Grade 12 candidates in the National Senior Certificate (NSC) exam.

The *Mind the Gap* study guide series is produced in both English and Afrikaans to assist those learners that have been underperforming due to a lack of exposure to the content requirements of the curriculum. The series aims to mind-the-gap between failing and passing, by bridging-the-gap in learners’ understanding of commonly tested concepts so candidates can pass.

The *Mind the Gap* study guide series takes its brief in part from the 2011 National Diagnostic report on learner performance. The marking and moderation process has revealed that candidates consistently perform poorly in certain basic concepts. The *Mind the Gap* study guides also draw on the Grade 12 Examination Guidelines.

Each of the *Mind the Gap* study guides provide explanations of key terminology, simple explanations and examples of the types of questions that learners can expect to be asked in an exam. Model answers are included to assist learners in building their understanding. Learners are also referred to specific questions in past national exam papers and exam memos that are available on the Department’s website – www.education.gov.za

The study guides have been written by subject expert teams comprised of teachers, examiners, moderators, subject advisors and subject co-ordinators. All that is now required is for our Grade 12 learners to put in the hours studying hard for the exams. It should be remembered that the support of the teachers and parents is also of utmost importance as they are responsible for supporting the learning process at school and at home.

It is my fervent wish that the *Mind the Gap* study guide series takes us all closer towards ensuring that no learner is left behind.

Learners make us proud – study hard. We wish you all good luck for your Grade 12 exams.

Matsie Angelina Motshekga, MP
Minister of Basic Education
July 2012

Mr Enver Surty, MP
Deputy Minister of Basic Education
July 2012
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## Appendix: Past exam paper

Appendix: Past exam paper: 151
Dear Grade 12 learner

This Mind the Gap study guide helps you to prepare for the end-of-year Economics Grade 12 exam.

The study guide does NOT cover the entire curriculum, but it does focus on core content of each knowledge area and points out where you can earn easy marks.

You must work your way through this study guide to improve your understanding, identify your areas of weakness and correct your own mistakes. To ensure a high-quality pass, you should also cover the remaining parts of the curriculum using other textbooks and your class notes. We are confident that this Mind the Gap study guide can help you to prepare well so that you pass the end-of-year exams.

The importance of your success cannot be over-emphasised. You form part of the future generation, and we all hope for a better future, a future where all our young South Africans can enjoy a high standard of living.

Overview of the exam for Economics Grade 12

The Economics exam consists of one 3 hour paper of 300 marks. The paper consists of TEN questions divided into three sections. Question ONE is COMPULSORY. There are NINE other questions from which FIVE must be answered. The detailed requirements for each section are shown below:

<table>
<thead>
<tr>
<th>SECTION A: COMPULSORY</th>
</tr>
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<tbody>
<tr>
<td>QUESTION 1: 50 MARKS – 25 MINUTES</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>SECTION B: ANSWER ANY THREE QUESTIONS FROM THIS SECTION</th>
</tr>
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<tr>
<td>QUESTION 2: 50 MARKS - 25 MINUTES</td>
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<td>QUESTION 3: 50 MARKS – 25 MINUTES</td>
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<td>QUESTION 4: 50 MARKS – 25 MINUTES</td>
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<td>QUESTION 5: 50 MARKS – 25 MINUTES</td>
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</table>

<table>
<thead>
<tr>
<th>QUESTION 6: 50 MARKS - 25 MINUTES</th>
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</thead>
<tbody>
<tr>
<td>THE TWO TOPICS USED IN THIS QUESTION ROTATE ANNUALLY.</td>
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</table>

<table>
<thead>
<tr>
<th>SECTION B: ANSWER ANY TWO QUESTIONS FROM THIS SECTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>QUESTION 7: 50 MARKS – 40 MINUTES</td>
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<tr>
<td>QUESTION 8: 50 MARKS – 40 MINUTES</td>
</tr>
<tr>
<td>QUESTION 9: 50 MARKS – 40 MINUTES</td>
</tr>
<tr>
<td>QUESTION 10: 50 MARKS – 40 MINUTES</td>
</tr>
</tbody>
</table>

Inflation is when you pay R15 for the R10 haircut you used to get for R5 when you had hair!
Essays play a very big role in your success in Economics, because you must choose TWO essays to answer, counting a 100 marks out of the grand total of 300 marks. Each essay counts 50 marks. This study guide includes essay topics that have been asked in past question papers. Make sure that you study each of these topics in detail in your preparation for your preparatory and final papers.

Never leave a question unanswered if you are asked to offer your own opinion. Remember: each section includes questions that are easy and almost-easy, so make sure you get these marks too.

Good luck for your NSC exams, your doorway to a better future. Dream big, set your goals and go for it!
How to use this study guide

<table>
<thead>
<tr>
<th>Icon</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>📝</td>
<td>Pay special attention</td>
</tr>
<tr>
<td>🔮</td>
<td>Hint</td>
</tr>
<tr>
<td>📙</td>
<td>Hints to help you remember a concept or guide you in solving problems</td>
</tr>
<tr>
<td>📦</td>
<td>Worked examples</td>
</tr>
<tr>
<td>📖</td>
<td>Step-by-step instructions</td>
</tr>
<tr>
<td>📆</td>
<td>Exams</td>
</tr>
<tr>
<td>🔍</td>
<td>Refers you to past exam papers</td>
</tr>
<tr>
<td>☀️</td>
<td>Activities with questions for you to answer</td>
</tr>
</tbody>
</table>

- The study guide includes a table of **key concepts with definitions** which need to be learnt off by heart. You can gain easy marks for the recall of definitions in the single mark questions.

- A **checklist from the exam guidelines** for Economics has been provided on page xvi for you to keep track of your progress. Once you have mastered the core concepts and have confidence in your answers to the questions provided, tick the last column of the checklist.

- The **activities are based on exam-type questions**. Cover the answers and do the activity on your own. Then check your answers. Reward yourself for the things you get right. If you get any incorrect answers, make sure you understand where you went wrong before moving on to the next section.

- Each **learning outcome** is briefly covered according to the exam guidelines. Valuable guidelines are provided to help you answer questions on graphs.

- A **past exam paper** is included in the study guide for you to do. Check your answers by looking back at your notes and the exam memoranda. Past exam papers go a long way in preparing you for what to expect and help reduce exam anxiety. Go to [www.education.gov.za](http://www.education.gov.za) to download more past exam papers.

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*A study of economics usually reveals that the best time to buy anything is last year.*

**Marty Allen**
Top 10 study tips

1. Have all your materials ready before you begin studying – pencils, pens, highlighters, paper, etc.

2. Be positive. Make sure your brain holds onto the information you are learning by reminding yourself how important it is to remember the work and get the marks.

3. Take a walk outside. A change of scenery will stimulate your learning. You’ll be surprised at how much more you take in being outside in the fresh air.

4. Break-up your learning sections into manageable parts. Trying to learn too much at one time will only result in a tired, unfocused and anxious brain.

5. Keep your study sessions short but effective and reward yourself with short, constructive breaks.

6. Teach your concepts to anyone who will listen. It might feel strange at first, but it is definitely worth reading your revision notes aloud.

7. Your brain learns well with colours and pictures. Try to use them whenever you can.

8. Be confident with the learning areas you know well and focus your brain energy on the sections that you find more difficult to take in.

9. Repetition is the key to retaining information you have to learn. Keep going, don’t give up.

10. Sleeping at least 8 hours every night, eating properly and drinking plenty of water are all important things you need to do for your brain. Studying for exams is like tough exercise, so you must be prepared physically.

The golden rule of effective study is the ABC - Apply Bottom to Chair!
Question words to help you answer questions

It is important to look for the question words (the words that tell you what to do) to correctly understand what the examiner is asking. Use the words in the following table as a guide when answering questions.

<table>
<thead>
<tr>
<th>Question word</th>
<th>What is required of you</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account for</td>
<td>Explain the cause of; explain why; give reasons for</td>
</tr>
<tr>
<td>Analyse</td>
<td>Separate; examine and interpret critically; positives and negatives; pros and cons</td>
</tr>
<tr>
<td>Argue</td>
<td>Put forward reasons in support of or against a statement</td>
</tr>
<tr>
<td>Assess</td>
<td>Estimating the nature, quality or value of something</td>
</tr>
<tr>
<td>Calculate</td>
<td>Use maths to work out an answer</td>
</tr>
<tr>
<td>Classify</td>
<td>Place things with similar characteristics in the same group; to arrange according to type or sort</td>
</tr>
<tr>
<td>Comment</td>
<td>Give your opinion, based on facts</td>
</tr>
<tr>
<td>Compare</td>
<td>To list both similarities and differences</td>
</tr>
<tr>
<td>Contrast</td>
<td>Stress the differences between things, events or problems</td>
</tr>
<tr>
<td>Critically</td>
<td>Analyse something, expressing agreement or disagreement with it</td>
</tr>
<tr>
<td>Define</td>
<td>Give a short and clear meaning</td>
</tr>
<tr>
<td>Demonstrate</td>
<td>Show or make clear; illustrate or explain; prove by reasoning and evidence (note that you can give examples)</td>
</tr>
<tr>
<td>Describe</td>
<td>List the main characteristics of something; give an account of (note that a diagram or map may be part of a description)</td>
</tr>
<tr>
<td>Discuss</td>
<td>Give the reasons for your statement; present both sides and reach a conclusion</td>
</tr>
<tr>
<td>Evaluate</td>
<td>Express an opinion, using evidence, of how good/bad, negative/positive, successful/unsuccessful something is</td>
</tr>
<tr>
<td>Examine</td>
<td>Look at something carefully and in detail</td>
</tr>
<tr>
<td>Explain</td>
<td>Make clear, interpret, and spell out the material you present. Give reasons for differences of opinion or of results</td>
</tr>
<tr>
<td>Give</td>
<td>To state facts without discussions or explanations (note that you may be asked to ‘Give a reason’)</td>
</tr>
<tr>
<td>Identify</td>
<td>Single out one particular piece of information</td>
</tr>
<tr>
<td>Illustrate</td>
<td>Explain or make something clear by using examples, charts, pictures and drawings</td>
</tr>
<tr>
<td>Interpret</td>
<td>To give an explanation of; to give the meaning of</td>
</tr>
<tr>
<td>List</td>
<td>Writing a list of the facts in their simplest form</td>
</tr>
<tr>
<td>State</td>
<td>Write down information without discussion</td>
</tr>
<tr>
<td>Suggest</td>
<td>Give possible reasons or ideas</td>
</tr>
<tr>
<td>Summarise</td>
<td>Reduce a lot of information to its main points</td>
</tr>
</tbody>
</table>

Examples of question words

Refer to Table 1.2.2 (income method) and answer the following questions:

1. **Which organisation** is responsible for the recording and publishing of GDP figures in South Africa? (2)
2. **Explain** the concept ‘subsidies on products’. (3)
3. **Give** TWO examples of taxes on products. (4)
4. **Calculate** the consumption of fixed capital in 2009 as a percentage of GDP at market price. **Show all calculations.** (4)
Study skills to boost your learning

This guide makes use of three study techniques you can use to help you learn the material:
1. Mobile notes
2. Mnemonics
3. Mind maps

Mobile notes

Mobile notes are excellent tools for learning all the key concepts in the study guide. Mobile notes are easy to make and you can take with them with you wherever you go:

1. Fold a blank piece of paper in half. Fold it in half again. Fold it again.
2. Open the paper. It will now be divided into 8 parts.
3. Cut or tear neatly along the folded lines.
4. On one side, write the basic concept.
5. On the other side, write the meaning or the explanation of the basic concept.
6. Use different colours and add pictures to help you remember.
7. Take these mobile notes with you wherever you go and look at them whenever you can.
8. As you learn, place the cards in three different piles:
   - I know well
   - Getting there
   - I need more practice
9. The more you learn them, the better you will remember them.
Mnemonics

A mnemonic code is a useful technique for learning information that is difficult to remember. This is an example of a word mnemonic using the word DEVELOP, where each letter of the word stands for something else:

D - Don’t stress
E - Eat healthy
V - Visualise your goals
E - Exercise body and brain
L - Learn everything well
O - Organise yourself
P - Practise Practise Practise

Mnemonics code information and make it easier to remember.

The more creative you are and the more you link your ‘codes’ to familiar things, the more helpful your mnemonics will be.

This guide provides several ideas for using mnemonics. Be sure to make up your own.
Mind maps

There are several mind maps included in this study guide, which summarise some of the sections.

Have a look at the following pictures of a brain cell (neuron) and a mind map:

Figure 1: Brain cell or neuron

Figure 2: Mind map rules

Mind maps work because they show information that we have to learn in the same way that our brains ‘see’ information.

As you study the mind maps in the guide, add pictures to each of the branches to help you remember the content.

You can make your own mind maps as you finish each section.

How to make your own mind maps

1. Turn your paper sideways so your brain has space to spread out in all directions.

2. Decide on a name for your mind map that summarises the information you are going to put on it.

3. Write the name in the middle and draw a circle or bubble or picture around it.

4. Only write key words on your branches, not whole sentences. Keep it short and simple.

5. Each branch should show a different idea. Use a different colour for each idea. Connect the information that belongs together. This will help build your understanding of the learning areas.

6. Have fun adding pictures wherever you can. It does not matter if you can’t draw well.

A picture says a 1000 words.
TOP 10 exam tips

1. Make sure you have all the necessary stationery for your exam, i.e. pens, pencils, eraser, calculator (with new batteries), as well as your ID document and exam admission letter.

2. Arrive on time, at least one hour before the start of the exam.

3. Go to the toilet before entering the exam room. You don’t want to waste valuable time going to the toilet during the exam.

4. Use the 10 minutes reading time to read the instructions carefully. This helps to ‘open’ the information in your brain. Start with the question you think is the easiest to get the flow going.

5. Break the questions down to make sure you understand what is being asked. If you don’t answer the question properly you won’t get any marks for it. Look for the key words in the question to know how to answer it. A list of these words is on page xi of this study guide.

6. Try all questions. Each question has some easy marks in it so make sure that you do all the questions in the exam.

7. Never panic, even if the question seems difficult at first. It will be linked with something you have covered. Find the connection.

8. Manage your time properly. Don’t waste time on questions you are unsure of. Move on and come back if time allows.

9. Check weighting – how many marks have been allocated for your answer? Take note of the ticks in this study guide as examples of marks allocated. Do not give more or less information than is required.

10. Write big and bold and clearly. You will get more marks if the marker can read your answer clearly.
Learner’s Checklist

Use this checklist to monitor your progress when preparing for the exam. The ticks (√) tell you which aspects of the curriculum are covered in the study guide. The stars (*) tell you to go to textbooks and class notes.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Aspect of the curriculum</th>
<th>Covered in study guide</th>
<th>I do not understand</th>
<th>I understand</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LO1: MACRO-ECONOMICS</strong></td>
<td></td>
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<tr>
<td>Open economy circular flow model (LO1 AS1)</td>
<td>Concepts</td>
<td>✔</td>
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<td></td>
<td>Participants:</td>
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<td></td>
<td>Households</td>
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<td>Business sector</td>
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<td>Government</td>
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<td>Foreign sector</td>
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<td>Four-sector circular flow diagram</td>
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<td>Real flows and money flows</td>
<td>✔</td>
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<td></td>
<td>Leakages (L = S + T + M) and injections (J = I + G + X)</td>
<td>✔</td>
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<td>✔</td>
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<tr>
<td></td>
<td>Equations</td>
<td>✔</td>
<td></td>
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<tr>
<td>Markets (in circular flow context):</td>
<td>Product and factor</td>
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<td>✔</td>
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<td></td>
<td>Financial (money and capital)</td>
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<td>Foreign exchange</td>
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<td></td>
<td>Flows through different markets (production, income, spending)</td>
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<td>✔</td>
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<td>National account aggregates and conversions</td>
<td>Concepts:</td>
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<td>– GDP and GNP</td>
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<td>– GDE</td>
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<td>– GDI</td>
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<td>Methods to derive aggregates:</td>
<td>Production (GDP)</td>
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<td>Expenditure (GDE)</td>
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<td>Income (GDI)</td>
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<td>Deduce and analyse national account aggregates (e.g. GDP, GDE and GDI)</td>
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<td>National account conversions:</td>
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<td>Factor cost</td>
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<td>National and domestic figures</td>
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<td>Multiplier:</td>
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<td>Derivation (formula, calculation and graph)</td>
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<td>Application (relate to all sectors of the economy)</td>
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<td>Business cycles and forecasting (LO1 AS2)</td>
<td>Composition and features of business cycles:</td>
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<td></td>
<td>• Nature</td>
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<td>• Interpretation</td>
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<td>• Actual business cycles</td>
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<td>Explanations:</td>
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<td>• Causes of business cycles:</td>
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<td>• Endogenous</td>
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<td>Kinds of business cycles:</td>
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<td>• Kitchin</td>
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<td>• Juglar</td>
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<td>• Kuznets</td>
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<td>• Kondratieff</td>
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<td>Government policy:</td>
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<td>• Aim</td>
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<td>• Fiscal and monetary policy regarding business cycles</td>
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<td>New economic paradigm (smoothing of cycles):</td>
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<td>Measures to smooth cycles</td>
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<td>Features underpinning forecasting regarding business cycles:</td>
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<td>• Leading indicators</td>
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<td>• Co-incident indicators</td>
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<td>• Length of business cycles</td>
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<td>• Amplitude</td>
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<td>Composition of public sector:</td>
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<td>Necessity of public sector</td>
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<td>Objectives of public sector and its budgets:</td>
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<td>• Full employment</td>
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<td>• Economic equity</td>
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<td>Budget:</td>
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<td>• Types</td>
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<td>• Features and composition</td>
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<td>• Assessing needs</td>
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<td>• Pricing policy</td>
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<td>• Parastatals</td>
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<td>• Privatisation</td>
<td>✓</td>
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<td><strong>Fiscal policy including Laffer curve:</strong></td>
<td>• Features</td>
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<td></td>
<td>• Effects (including the Laffer curve)</td>
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<td><strong>Reasons for public sector failure:</strong></td>
<td>• Features</td>
<td>✓</td>
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<td></td>
<td>• Reasons for public sector failure</td>
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<td>• Effects (e.g. on health, socio-economic rights, education)</td>
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<td><strong>The foreign exchange market and the balance of payments accounts (LO1 AS4)</strong></td>
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<td><strong>Reasons for international trade:</strong></td>
<td>• Demand reasons</td>
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<td></td>
<td>• Supply reasons</td>
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<td>• Interaction of demand and supply</td>
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<td><strong>Balance of payments account:</strong></td>
<td>• Concept</td>
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<td>• Composition:</td>
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<td>• Current account</td>
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<td>• Capital transfer account</td>
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<td>• Financial account</td>
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<td>• Reserves account</td>
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<td><strong>Foreign exchange markets:</strong></td>
<td>• Concepts:</td>
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<td></td>
<td>• Foreign exchange</td>
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<td>• Exchange rate</td>
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<td>• Revaluation</td>
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<td>• Devaluation</td>
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<td>• Appreciation</td>
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<td>• Depreciation</td>
<td>✓</td>
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<td></td>
<td>• Exchange rate systems (e.g. free floating, fixed rate system and managed float system)</td>
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<td>• Exchange control</td>
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<td><strong>Differences in currencies</strong></td>
<td>• Factors influencing supply and demand of foreign exchange</td>
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<td><strong>Establishment of exchange rates (price information)</strong></td>
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<td><strong>Interventions in the markets</strong></td>
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<td><strong>Corrections of balance of payments disequilibria:</strong></td>
<td>• Lending and borrowing (supply)</td>
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<td>• Changes in demand</td>
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<td>• Changes in exchange rates</td>
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<td><strong>LO2: MICRO-ECONOMICS</strong></td>
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<td>The dynamics of perfect markets (LO2 AS1)</td>
<td>Perfect competition:</td>
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<td>• Concept</td>
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<td>• Conditions</td>
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<td>Market structure</td>
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<td>Individual businesses:</td>
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<td>• Profits</td>
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<td>• Losses and supply</td>
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<td>• <strong>Short-term equilibrium:</strong></td>
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<td>– Economic losses</td>
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<td>– Economic profits</td>
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<td>– Normal profits</td>
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<td>• Long-term equilibrium</td>
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<td>Industry:</td>
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<td>• <strong>Short-term equilibrium:</strong></td>
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<td>– Profit and losses</td>
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<td>Competition policies:</td>
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<td>• Aims</td>
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<td>• Instruments of competition policy in South Africa</td>
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<td>The reasons for and consequences of market failures (LO2 AS2)</td>
<td>Causes of market failures:</td>
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<td>• <strong>Causes:</strong></td>
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<td>– Externalities</td>
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<td>– Public goods</td>
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<td>– Merit and demerit goods</td>
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<td>– Incomplete information</td>
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<td>– Immobility of factors of production</td>
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<td>– Imperfect distribution of income and wealth</td>
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<td>– Imperfect competition</td>
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<td>Consequences of market failures:</td>
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<td>• Inefficiencies (refer to Pareto inefficiency)</td>
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<td>• <strong>Government intervention:</strong></td>
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<td>– Preventing the misallocation</td>
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<td>– Improving income distribution</td>
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<td>– Enhancing macroeconomic stability</td>
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<td>Cost-benefit analysis:</td>
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<td>• Price mechanism</td>
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<td>The dynamics of imperfect markets (LO2 AS3)</td>
<td>Dynamics of imperfect markets with aid of cost and revenue curves:</td>
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<td>• Monopolies:</td>
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<td>– Revenue</td>
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<td>– Short-term equilibrium: Profit and loss</td>
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<td>– Long-term: Profit and loss</td>
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<td>– Comparison with perfect markets</td>
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<td>• Oligopolies:</td>
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<td>– Comparison with perfect markets</td>
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<table>
<thead>
<tr>
<th>LO3: ECONOMIC PURSUITS</th>
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</thead>
<tbody>
<tr>
<td>South African growth and development policies (LO3 AS1)</td>
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</table>

<p>| South Africa’s industrial development policies (LO3 AS2) | Regional industrial development: |
| | • Rationale | ✓ |
| | • Best practice principles | ✓ |
| | Policies (SDIs and related policies, IDZ, Asgi-SA, etc) | ✓ |
| | Latest government initiatives | ✓ |
| | The appropriateness of South African strategies | ✓ |</p>
<table>
<thead>
<tr>
<th>Topic</th>
<th>Aspect of the curriculum</th>
<th>Covered in study guide</th>
<th>I do not understand</th>
<th>I understand</th>
</tr>
</thead>
</table>
| Protectionism and free trade (LO3 AS3) | Export promotion:  
• Concept  
• Reasons  
• Methods  
• Advantages  
• Disadvantages | ✓                      |                      |              |
| | Import substitution:  
• Concept  
• Reasons  
• Methods  
• Advantages  
• Disadvantages | ✓                      |                      |              |
| | Protectionism:  
• Concept  
• Argument | ✓                      |                      |              |
| | Free trade:  
• Concept  
• Argument | ✓                      |                      |              |
| | Desirable mix | ✓                      |                      |              |
| | Globalisation (WTO, AGOA) | *                      |                      |              |
| | Evaluation of South African international trade policies:  
• Import substitution and export promotion  
• Protectionism and free trade  
• Trade liberalisation | *                      |                      |              |
| South African economic and social indicators (LO3 AS4) | Assessing the performance of an economy | ✓                      |                      |              |
| | Economic indicators:  
• Production  
• Inflation rate  
• Foreign trade  
• Employment  
• Productivity  
• Interest rates  
• Money supply | ✓                      |                      |              |
| | Social indicators:  
• Health and nutrition  
• Education  
• Services  
• Housing and urbanisation | ✓                      |                      |              |
<p>| | International comparisons | ✓                      |                      |              |</p>
<table>
<thead>
<tr>
<th>Topic</th>
<th>Aspect of the curriculum</th>
<th>Covered in study guide</th>
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<td><strong>Inflation (LO4 AS1)</strong></td>
<td><strong>Concepts</strong></td>
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<td><strong>Kinds and characteristics:</strong></td>
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<td></td>
<td>• Consumer</td>
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<td>• Producer</td>
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<td>• All-inclusive</td>
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<td></td>
<td>• Hyperinflation</td>
<td>✓</td>
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<td></td>
<td>• Stagflation</td>
<td>✓</td>
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<td></td>
<td><strong>Causes of demand-pull</strong></td>
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<td></td>
<td><strong>Causes of cost-push</strong></td>
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<td><strong>Inflation problem in South Africa:</strong></td>
<td></td>
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<tr>
<td></td>
<td>• Historical perspective</td>
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<td>• Short-term problems</td>
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<td>• Long-term problems</td>
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<td>• Measurement</td>
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<td></td>
<td><strong>Policies used to combat inflation:</strong></td>
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<tr>
<td></td>
<td>• Fiscal</td>
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<td>• Monetary</td>
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<td></td>
<td>• Other</td>
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<td><strong>The state of the environment:</strong></td>
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<td></td>
<td>• Pollution</td>
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<td></td>
<td>• Conservation</td>
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<td>• Preservation</td>
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<td>• Externalities</td>
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<td><strong>Measures to ensure sustainability:</strong></td>
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<td></td>
<td>• Market-related policies</td>
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<td></td>
<td>• Public sector intervention</td>
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<td>• Public sector control</td>
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<td>• International measures</td>
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<td></td>
<td><strong>International agreements:</strong></td>
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<td></td>
<td>• Rio de Janiero Summit</td>
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<td>• Kyoto Protocol on climate change (1997)</td>
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<td></td>
<td>• World Summit on Sustainable Development (2002)</td>
<td>✓</td>
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<td><strong>Economic issues of today (LO4 AS4)</strong></td>
<td><strong>Evaluation of economic issues of the day</strong></td>
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<td></td>
<td><strong>Presentation of relevant economic issues</strong></td>
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<td><strong>Quantitative elements of Economics:</strong></td>
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<td>• Mathematical expressions</td>
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<td>• Coefficients</td>
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<td>• Tables and graphs</td>
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<td><strong>Other essentials:</strong></td>
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<td></td>
<td>• Citizenship and life skills (e.g. completing forms)</td>
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<tr>
<td></td>
<td>• Subject-related competitions and practical activities</td>
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</tbody>
</table>
The circular flow model, national account aggregates and the multiplier are three key terms in Economics.

According to the circular flow model, the three key sectors of the economy (consumer, business and government) all work together to ensure that society’s needs are provided for through the creation of goods and services.

The national account aggregates are an important means of analysing the performance of a country. The most important of these aggregates is the Gross Domestic Product (GDP).

The multiplier is an equation used to determine the marginal propensity to consume (the amount of each rand people will use for consumption) within a country at a particular time.

**The circular flow model, national account aggregates and the multiplier**

1.1 Key concepts
1.2 The role of participants in the circular flow model
   1.2.1. Household sector
   1.2.2. Firms/business sector
   1.2.3. The state/public sector
   1.2.4. Foreign sector
   1.2.5. Real and money flow
   1.2.6. Leakages and injections
1.3 National account aggregates
   1.3.1. Production (output/value added) method
   1.3.2. Income method
   1.3.3. Expenditure method
   1.3.4. Key national account conversions
      1A. How to convert domestic totals to national totals
      2B. How to convert GDP at factor cost to GDP at basic prices or market prices
1.4 The multiplier

Formula: $M = \frac{1}{1 - mpc}$
These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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</thead>
<tbody>
<tr>
<td>Base year</td>
<td>A year with very small price changes or price fluctuations. The current base year used by the Reserve Bank is 2005.</td>
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<tr>
<td>Basic prices (bp)</td>
<td>Used when GDP is calculated according to the production method and represents the production costs of firms</td>
</tr>
<tr>
<td>Capital market</td>
<td>Where consumers and producers make long-term deposits and borrow</td>
</tr>
<tr>
<td>Circular flow model</td>
<td>Continuous flow of spending, production and income between different sectors</td>
</tr>
<tr>
<td>Closed economy</td>
<td>An economy that has no foreign sector as a participator</td>
</tr>
<tr>
<td>Consumption (C)</td>
<td>Consumption spending by the population</td>
</tr>
<tr>
<td>Domestic figures (GDP)</td>
<td>Value of all final goods and services produced within the borders of a country for a specific period</td>
</tr>
<tr>
<td>Economic equilibrium</td>
<td>The economy is in equilibrium if leakages are equal to injections: ( L = J ) or ( S + T + M = I + G + X )</td>
</tr>
<tr>
<td>Expenditure method</td>
<td>When the national accountants add together the spending of the four major sectors of the economy: ( C + G + I + (X - M) )</td>
</tr>
<tr>
<td>Exports (X)</td>
<td>Goods and services produced locally and then sold for consumption outside the borders of the country</td>
</tr>
<tr>
<td>Factor cost</td>
<td>Represents the amount received by the various factors of production</td>
</tr>
<tr>
<td>Factor market</td>
<td>Market where factors of production are traded, e.g. labour market</td>
</tr>
<tr>
<td>Factor price</td>
<td>Amount earned by the different factors of production in goods and services production – when income method is followed</td>
</tr>
<tr>
<td>Financial market</td>
<td>The market where both short- and long-term financial assets are traded</td>
</tr>
<tr>
<td>Financial sector</td>
<td>Those financial institutions that are not directly involved in the production of goods and services, e.g. banks, insurance companies, pension funds and the JSE</td>
</tr>
<tr>
<td>Foreign exchange market</td>
<td>The market in which one currency can be traded for another, e.g. rands for dollars</td>
</tr>
<tr>
<td>Goods market</td>
<td>Market where goods and services are traded, e.g. cars, milk</td>
</tr>
<tr>
<td>Government (G)</td>
<td>The expenditure of the government sector</td>
</tr>
<tr>
<td>Imports (M)</td>
<td>Goods and services produced in other countries and purchased by local firms or households</td>
</tr>
<tr>
<td>Income method</td>
<td>Gross Domestic Income is derived by adding all income earned by the owners of the factors of production – GDP(I)</td>
</tr>
<tr>
<td><strong>Injections (J)</strong></td>
<td>The introduction of additional money into the economy by investment (I), government (G), and payments for exports (X)</td>
</tr>
<tr>
<td>--------------------</td>
<td>----------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Investments (I)</strong></td>
<td>Spending by firms on capital goods</td>
</tr>
<tr>
<td><strong>Leakages (L)</strong></td>
<td>Money withdrawn from the circular flow, e.g. through savings (S), taxes (T) and import expenditure (M)</td>
</tr>
<tr>
<td><strong>Marginal propensity to consume (MPC)</strong></td>
<td>The marginal propensity to consume (MPC) indicates that, as disposable income increases, an increase in personal consumer spending (consumption) occurs. For example, a marginal propensity to consume of 0.65 indicates that for every extra rand earned, the household will spend 65 cents and save 35 cents.</td>
</tr>
<tr>
<td><strong>Market price (mp)</strong></td>
<td>Prices actually paid by consumers for goods and services plus all taxes less subsidies. Calculated according to the expenditure method</td>
</tr>
<tr>
<td><strong>Money flow</strong></td>
<td>The flow of income and expenditure between the participants in the circular flow</td>
</tr>
<tr>
<td><strong>Money market</strong></td>
<td>The short-term and very short-term market for savings and loans</td>
</tr>
<tr>
<td><strong>Multiplier</strong></td>
<td>A small initial increase in spending produces a proportionately larger increase in aggregate national income</td>
</tr>
<tr>
<td><strong>National figures (GNP)</strong></td>
<td>Value of all final goods and services produced by the permanent citizens of the country for a specific period</td>
</tr>
<tr>
<td><strong>Net figures</strong></td>
<td>Net indicates that some amount has been taken away, e.g. net exports reflects the value of exports less imports.</td>
</tr>
<tr>
<td><strong>Open economy</strong></td>
<td>An economy that trades with the foreign sector</td>
</tr>
<tr>
<td><strong>Production method</strong></td>
<td>The adding of final values of all goods and services calculated as gross value added – GDP(P)</td>
</tr>
<tr>
<td><strong>Real flow</strong></td>
<td>The flow of goods and services between the participants in the circular flow</td>
</tr>
<tr>
<td><strong>Savings (S)</strong></td>
<td>Income that is not consumed</td>
</tr>
<tr>
<td><strong>Subsidies on production</strong></td>
<td>Refers to subsidies that are not linked to specific goods or services, e.g. subsidy made on employment</td>
</tr>
<tr>
<td><strong>Subsidies on products</strong></td>
<td>Financial incentives to help struggling industries produce, as well as direct subsidies payable per unit exported to encourage exports (e.g. government subsidy on bread)</td>
</tr>
<tr>
<td><strong>Taxes (T)</strong></td>
<td>Compulsory payments made by private individuals or business enterprises to the government sector with no direct benefit</td>
</tr>
<tr>
<td><strong>Taxes on production</strong></td>
<td>Refer to taxes on production not linked to a specific good or service (e.g. tax on land and buildings)</td>
</tr>
<tr>
<td><strong>Taxes on products</strong></td>
<td>Taxes that are payable per unit of some good or service (e.g. VAT, import duties)</td>
</tr>
</tbody>
</table>
1.2 The role of participants in the circular flow model

Learn these six major participants in the circular flow model.

1.2.1. Household sector
- Households are the major consumers of economic goods and services – they use their income to buy from firms.
- Households are the primary economic participants because they are the owners of the four factors of production.
- Households sell factors of production in the factor market to firms.
- Households receive a remuneration from the firms in the form of wages, rent, interest and profit.

1.2.2. Firms/business sector
- Firms purchase the factors of production from the household in the factor market.
- Firms use the factors of production to produce goods and services.
- Businesses sell goods and services to households, government and the foreign sector.
- Businesses receive an income from the other three participants (households, government and the foreign sector).

1.2.3. The state/public sector
- This refers to local, regional and national government.
- The state provides the households and businesses with public goods and services.
- The state receives taxes from households, e.g. income tax.
- The state receives taxes from the business sector, e.g. company tax.

1.2.4. Foreign sector
- This is a flow of goods or imports that flow from the foreign sector and are paid for by the individual household, business and the public sector.
- These imports can be seen as an expenditure for the individual household, business and public sector.
- There is also a flow of goods and services to the foreign sector from businesses (exports).
- These exports will be an income for the individual household, business and public sector.
1.2.5. Real and money flow

- **Real flow**: Factors of production flow from the owners (households) to producers via the factor markets. Goods and services flow from the producers via the goods markets to households and other users of goods and services. Factors of production and goods and services flow from foreign countries to South Africa (**imports**). Factors of production and goods and services flow from South Africa to foreign countries (**exports**).

- **Money flow**: Factor remuneration represents the expenditure of producers and the income of households (wages, rent, interest and profit). On the other hand, consumption expenditure represents the expenditure of households and the income of producers.

Figure 1.1 below is a typical example of an open economy circular flow model.

---

**Figure 1.1 An open economy circular flow model**

"You must be able to draw a detailed diagram of a circular flow model. Figure 1.1 is a typical example of an open economy circular flow model."
1.2.6. Leakages and injections

**Leakages** refer to the outflow of money from the economy. The following are leakages or withdrawals from the circular flow:
- Savings (S)
- Taxation (T)
- Payment for Imports (M)

**Injections** refer to an inflow of money into the economy. The following are injections (additions to) the circular flow:
- Investment (I)
- Government expenditure (G)
- Payments for exports (X)

### Activity 1

Study the diagram below and answer the questions that follow:

![Diagram]

1.1 Use the information below and calculate the values A – G: (7)

   - Total production: R25 000
   - Income Taxation: R 5 000
   - Savings: R4 000
   - Imports: R 3 700

1.2 Explain the impact of an increase in income taxes on the level of production. (3)

1.3 Calculate the total leakages (L) in the above diagram. (4)

1.4 Supply the formula that’s been used to calculate the GDP(E). (2)

1.5 If a country has a marginal propensity to save of 0.1, calculate the value of the multiplier. (4)
## Answers to activity 1

1.1 A – R20 000
   B – R25 000
   C – R5 000
   D – R4 000
   E – R16 000
   F – R3 700
   G – R12 300

1.2 Leads to a decline in production

1.3 $S + T + M$
   $R4 000 + R5 000 + R3 700$
   $R12 700$

1.4 $C + G + I + (X – M)$

1.5 $m = \frac{1}{1 - mpc}$
   $= \frac{1}{1 - 0.1}$
   $= \frac{1}{1.09}$
   $= 1.1$
1.3 National account aggregates

The national account aggregates are methods that are used to determine the value of the economy. The production method, income method and expenditure method are three different ways the economy is valued. They are all used at different times and for different purposes. Be sure you learn how to use these methods.

<table>
<thead>
<tr>
<th>PRODUCTION METHOD</th>
<th>INCOME METHOD</th>
<th>EXPENDITURE METHOD</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>GDP</td>
<td>GDP</td>
</tr>
<tr>
<td>Adds final values of all goods and services produced</td>
<td>Adds all income earned by owners of factors of production</td>
<td>Adds spending of four main economy sectors – consumption, government, investments and exports (minus imports)</td>
</tr>
</tbody>
</table>

1.3.1 The production (output/value added) method

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.

Table 1.2.1 shows the GDP in the different sectors of the economy for 2005 – 2011 in (R millions).

<table>
<thead>
<tr>
<th>VALUE ADDED</th>
<th>2005</th>
<th>2007</th>
<th>2009</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Primary sector</td>
<td>143 394</td>
<td>210 803</td>
<td>260 176</td>
<td>324 365</td>
</tr>
<tr>
<td>2. Secondary sector</td>
<td>330 669</td>
<td>403 129</td>
<td>478 626</td>
<td>556 708</td>
</tr>
<tr>
<td>3. Tertiary sector</td>
<td>927 004</td>
<td>1 178 144</td>
<td>1 435 710</td>
<td>1 789 431</td>
</tr>
<tr>
<td>4. Gross value added at basic prices</td>
<td>1 401 067</td>
<td>1 792 076</td>
<td>2 174 512</td>
<td>2 670 504</td>
</tr>
<tr>
<td>4.1 Plus - taxes on products</td>
<td>175 667</td>
<td>230 000</td>
<td>238 557</td>
<td>312 863</td>
</tr>
<tr>
<td>4.2 Less - subsidies on products</td>
<td>5 652</td>
<td>5 891</td>
<td>14 914</td>
<td>19 106</td>
</tr>
<tr>
<td>5. Gross domestic product at market prices</td>
<td>1 571 082</td>
<td>2 016 185</td>
<td>2 398 155</td>
<td>2 964 261</td>
</tr>
</tbody>
</table>

Table 1.2.1: GDP by economic sector for 2005-2011  
Source: SARB Quarterly Bulletin (Dec 2011)

If we merely add up the market values of all outputs, we obtain a total greatly in excess of the value of the economy’s actual output. Such a calculation would lead to double counting or multiple counting.
Activity 2

Study the following data and answer the question that follows:

Compensation of employees R1 086 907; Final consumption expenditure by households R1 472 824; Net operating surplus R728 426; Final consumption expenditure by government R504 169; Taxes on products R245 198; Subsidies on products R3 113; Taxes on production R38 173; Subsidies on production R 5 092; Gross capital formation R467 878; Exports of goods and services R667 740; Consumption of fixed capital R332 824; Primary sector R278 518; Secondary sector R466 749; Tertiary sector R1 435 971.

1. Determine the gross domestic product at market prices according to the production method. [10]

Answer to activity 2

1. 

Primary sector R278 518 ✓
Secondary sector R466 749 ✓
Tertiary sector R1 435 971 ✓
Gross value added at basic prices 2 181 238 ✓
Plus taxes on products R245 198 ✓
Less subsidies on products R3 113 ✓
Gross domestic product @ market price R2 423 323 ✓ [10]

1.3.2 The income method

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).

Table 1.2.2 Indicates the gross domestic income for the South African economy for 2005 – 2011 in (R millions).

<table>
<thead>
<tr>
<th>Income received through production factors R (bn)</th>
<th>2005</th>
<th>2007</th>
<th>2009</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Compensation of employees</td>
<td>699 018</td>
<td>882 379</td>
<td>1 077 833</td>
<td>1 317 655</td>
</tr>
<tr>
<td>2. Net operating surplus</td>
<td>485 761</td>
<td>629 116</td>
<td>731 204</td>
<td>937 150</td>
</tr>
<tr>
<td>3. Consumption of fixed capital</td>
<td>187 790</td>
<td>252 595</td>
<td>332 584</td>
<td>376 422</td>
</tr>
<tr>
<td>4. Gross value added @ factor cost</td>
<td>1 372 569</td>
<td>1 764 090</td>
<td>2 141 621</td>
<td>2 631 227</td>
</tr>
<tr>
<td>5. Other taxes on production</td>
<td>32 927</td>
<td>35 374</td>
<td>42 101</td>
<td>50 009</td>
</tr>
<tr>
<td>6. LESS other subsidies on production</td>
<td>4 421</td>
<td>7 388</td>
<td>9 210</td>
<td>10 732</td>
</tr>
<tr>
<td>7. Gross value added @ basic prices</td>
<td>1 401 067</td>
<td>1 792 076</td>
<td>2 174 512</td>
<td>2 670 504</td>
</tr>
<tr>
<td>8. Taxes on products</td>
<td>175 667</td>
<td>230 000</td>
<td>238 557</td>
<td>312 863</td>
</tr>
<tr>
<td>9. LESS subsidies on products</td>
<td>5 652</td>
<td>5 891</td>
<td>14 914</td>
<td>19 106</td>
</tr>
<tr>
<td>10 Gross domestic product @ market prices (GDI)</td>
<td>1 571 082</td>
<td>2 016 185</td>
<td>2 398 155</td>
<td>2 964 261</td>
</tr>
</tbody>
</table>

Table 1.2.2: South African GDP (I) for 2005-2011 Source: SARB Quarterly Bulletin (December 2011)
Activity 3

Refer to Table 1.2.2 (income method) and answer the following questions:

1. Which financial institution is responsible for the recording and publishing of GDP figures in South Africa? (2)
2. Explain the concept ‘subsidies on products’. (3)
3. Give TWO examples of taxes on products. (4)
4. Calculate the consumption of fixed capital in 2009 as a percentage of GDP at market price. Show all calculations. (4)
5. What is the difference between 2007 and 2011 concerning the GVA @ factor cost? (2)

Answers to activity 3

1. SARB
2. Direct subsidies are payable per unit exported to encourage exports, e.g. government subsidy on bread.
3. VAT, PAYE
4. \[ \frac{332584}{2398152} \times 100\% = 13.9\% \]
5. \[ 2631227 - 1764090 = 1258658 \]

1.3.3 The expenditure method

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

Table 1.2.3 shows total spending on GDP at market prices for 2005 – 2011 in (R millions).

<table>
<thead>
<tr>
<th>Spending within the borders of SA</th>
<th>2005</th>
<th>2007</th>
<th>2009</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Final consumption expenditure by households</td>
<td>990 773</td>
<td>1 264 726</td>
<td>1 460 911</td>
<td>1 737 277</td>
</tr>
<tr>
<td>2. Final consumption expenditure by government</td>
<td>305 733</td>
<td>380 004</td>
<td>502 492</td>
<td>636 446</td>
</tr>
<tr>
<td>3. Gross capital formation</td>
<td>282 130</td>
<td>428 231</td>
<td>470 963</td>
<td>584 955</td>
</tr>
<tr>
<td>4. Residual items</td>
<td>-164</td>
<td>-1 618</td>
<td>-15 095</td>
<td>23 598</td>
</tr>
<tr>
<td>5. Gross domestic expenditure</td>
<td>1 578 472</td>
<td>2 071 343</td>
<td>2 419 271</td>
<td>2 982 276</td>
</tr>
<tr>
<td>6. Exports of goods and services</td>
<td>430 169</td>
<td>634 626</td>
<td>657 192</td>
<td>854 343</td>
</tr>
<tr>
<td>7. LESS imports of goods and services</td>
<td>437 559</td>
<td>689 784</td>
<td>678 308</td>
<td>872 358</td>
</tr>
<tr>
<td>8. Gross domestic product @ market prices</td>
<td>1 571 082</td>
<td>2 016 185</td>
<td>2 398 155</td>
<td>2 964 261</td>
</tr>
</tbody>
</table>

Source: SARB Quarterly Bulletin (December 2011)

**Table 1.2.3: Total spending on GDP at market prices for 2005-2011**

NB: Table 1.2.3 shows that South Africa imported more goods and services than it exported in 2005. This caused a leakage from the circular flow to the value of about –R7 390 billion in 2005.
Two key national accounts conversions

1. How to convert domestic totals to national totals

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2007</th>
<th>2009</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP @ MARKET PRICES</td>
<td>1 571 082</td>
<td>2 016 185</td>
<td>2 398 155</td>
<td>2 964 261</td>
</tr>
<tr>
<td>PLUS: Primary income</td>
<td>29 550</td>
<td>48 448</td>
<td>34 075</td>
<td>38 118</td>
</tr>
<tr>
<td>from the rest of the world</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MINUS: Primary income</td>
<td>60 975</td>
<td>117 266</td>
<td>87 593</td>
<td>104 689</td>
</tr>
<tr>
<td>to the rest of the world</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GNP @ MARKET PRICES</td>
<td>1 539 657</td>
<td>1 947 367</td>
<td>2 344 637</td>
<td>2 897 690</td>
</tr>
</tbody>
</table>

Source: SARB Quarterly Bulletin (December 2011)

Table 1.2.4: How to convert domestic totals to national totals

Study Table 1.2.5 below and answer the questions that follow.

<table>
<thead>
<tr>
<th>NATIONAL ACCOUNT AGGREGATES</th>
<th>R MILLIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final consumption expenditure by households</td>
<td>1 473 490</td>
</tr>
<tr>
<td>Final consumption expenditure by government</td>
<td>505 040</td>
</tr>
<tr>
<td>Gross capital formation</td>
<td>467 878</td>
</tr>
<tr>
<td>Residual item</td>
<td>−18 092</td>
</tr>
<tr>
<td><strong>Gross Domestic Expenditure</strong></td>
<td><strong>2 428 316</strong></td>
</tr>
<tr>
<td>Export of goods and services</td>
<td>657 113</td>
</tr>
<tr>
<td>Import of goods and services</td>
<td>677 740</td>
</tr>
<tr>
<td><strong>Expenditure on GDP(E) at market prices</strong></td>
<td>A</td>
</tr>
</tbody>
</table>

Source: Quarterly Bulletin, SARB (June 2010)

Table 1.2.5: National account aggregates

1. Explain the concept gross capital formation. (2)
2. Calculate the value of A. Show all calculations. (4)
3. If one uses the production method to calculate the GDP(P) at market prices, will GDP(E) be more, equal or less? Motivate your answer. (3)
Answers to activity 4

1. Expenditure on assets used repeatedly in the process of production ✓ / Increase in the stock of capital ✓

2. GDE = 2 428 316 ✓
   + Exports = 657 113 ✓
   + Imports = 677 740 ✓
   R2 407 693m ✓

3. Equal ✓
   Production GDP(P) = income GDP(I) = expenditure GDP(E) ✓
   when calculating the GDP / because of the residual item ✓

2. How to convert GDP at factor cost to GDP at basic prices or market prices:

GDP @ factor cost to GDP at basic prices, or GDP at market prices:

GDP at basic price = GDP @ factor cost
   + tax on production
   − subsidies on production

GDP at market price = GDP at basic price
   + tax on products
   − subsidies on products

1.4. The multiplier

The multiplier is derived from the marginal propensity to consume (mpc). It is so called because a small initial increase in spending by the population produces a proportionately larger increase in the aggregate national income.

1.4.1 How to calculate the multiplier

We can measure the multiplier factor with the aid of the following formula:

\[ M = \frac{1}{1-\text{mpc}} \]

where mpc equals the marginal propensity to consume
E. G. Worked example

Suppose the marginal propensity to consume is 0.3. Calculate the value of the multiplier.

Use the multiplier formula to calculate:

\[ K = \frac{1}{1 - mpc} \]

\[ = \frac{1}{1 - 0.3} \]

\[ = \frac{1}{0.7} \]

\[ = 1.4 \]

Activity 5

Study the graph below of the multiplier in a two-sector model where the consumption function is given by \( C = c + c(Y) \) and answer the questions that follow.

1. Define the term multiplier. (3)
2. With reference to the graph, name the TWO sectors involved in deriving the macro-economic multiplier. (4)
3. Indicate what is represented by the dotted line. (2)
4. What is the value of autonomous consumption for the original consumption function? (2)
5. Suppose the marginal propensity to save (MPS) = 0.4. Use the multiplier formula to calculate the eventual change in aggregate income, if there was an injection of R10 billion into the economy. Show ALL the calculations. (HINT: Determine the size of the multiplier first.) (6)
6. Describe the relationship between the mpc and the multiplier. (3)
Answers to activity 5

1. The multiplier shows how an increase in spending (injection) produces a more than proportional increase in national income. (3)

2. Household ✓ Business ✓ (4)

3. Indicates all points where income = expenditure / 45° line / Keynesian equilibrium ✓ (2)

4. 20 bn ✓ (2)

5. \[ M = \frac{1}{mps} = \frac{1}{0.4} = 2.5 \] ✓ ✓ (6)

\[ 2.5 \times 10 \text{bn P} = 25 \text{bn}. \] ✓ ✓ ✓

6. The larger the MPC the bigger the multiplier and visa versa ✓ ✓ ✓ (3)

Exams

Below is a list of suggested past exam questions for extra practice:

- Economic models – November 2009, question 1.1.3
- The income method – November 2009, question 2.3
- The GDP deflator – November 2009, question 6.1.4
- Public goods – February 2010, question 1.1.1
- System of national accounts – February 2010, question 1.1.2
- Production – February 2010, question 1.2.3
- Indicators – February 2010, question 1.2.4
- The new economic paradigm – February 2010, question 1.3.1
- The multiplier – February 2010, question 2.3
- The multiplier – November 2010, question 1.1.3
- The multiplier – February 2011, question 6.1.3
- The value of goods and services – November 2010, question 1.2.1
- GDP – November 2010, question 6.2
- National income and production accounts – November 2010, question 6.3
- GDP at basic prices – February 2011, question 1.1.3
- GDP conversion – February 2011, question 6.3
Business cycles refer to fluctuations in economic activity or production over several months or years. They seem to indicate a long-term trend, typically involving shifts over time between periods of rapid economic growth (expansion or boom), and periods of stagnation or decline (contraction or recession).

Forecasting relates to the economic indicators used to forecast the trends in the business cycle.
2.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide.

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

2.2 An example of a business cycle

Graph 2.1 below shows economic activity over an extended period of time as the economy moves between periods of expansion and periods of contraction.

Graph 2.1 Business cycles (trend line)
As shown in Graph 2.1, economic activity clearly shows periods of contraction (recession/depression) and periods of expansion (recover/prosperity) in the economy.

- Economic activity is shown by the upward and downward movements of the curve.
- A period where there is a general increase in economic activity is known as an upswing.
- A period of general decline in economic activity is called a downswing.
- The business cycle oscillates between the upper (peak) and lower (trough) turning points.
- The length of the business cycle is measured from peak to peak or from trough to trough.
- The entire period from the peak to the trough is known as the downswing.
- The entire period from the trough to the peak is known as the upswing.
- The period immediately before and through the upper turning point of the cycle is called the boom.
- The period immediately before and through the lower turning point is known as the slump.
2.3 Causes of business cycles

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.

2.3.1. 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 company of interest.

- The monetarist approach is also called the sunspot theory.
- The monetarist approach believes markets are inherently stable.
- When a disequilibrium occurs (e.g. weather conditions and market shocks), market forces kick in and bring the market back to its equilibrium route.
- Governments should not intervene in the market.

Graph 2.2 shows a monetarist view of business cycles. Note how the trend line is thick, whilst the cycle line is thin. This indicates that the market is driven by a trend towards stability. Business cycles have a small impact on the overall long-term stability of the market.

2.3.2. The Keynesian (endogenous) approach

Endogenous variables are dependent variables. This follows the belief that economic growth is primarily the result of endogenous and not external forces.

- The Keynesian approach holds the view that markets are inherently unstable.
- The price mechanism fails to co-ordinate demand and supply in markets.
- Prices are not flexible enough (e.g. wages).
- A business cycle is an inherent feature of a market economy.
- Indirect links or mismatches between demand and supply are normal features of the economy.
Graph 2.3 shows a Keynesian view of business cycles. Note how the cycle line is thick, whilst the trend line is thin. This indicates that the market is driven by cycles and is inherently unstable. Business cycles have a major impact on the overall state of the market.

Graph 2.3 Keynesian approach

2.3.3. Government policy:
Monetary instruments

The government has numerous monetary instruments at its disposal to use when it mediates the impact of a boom or a bust. Some of these are:
1. Interest rates
2. Cash reserve requirements
3. Open market transactions
4. Moral persuasion
5. Exchange rate policy

2.3.4. The new economic paradigm

2.3.4A Demand-side policies

Demand-side policies include:
- **Inflation:**
  - Aggregate demand and supply are in equilibrium.
  - When the demand increases, the supply will react in the same way.
  - If the supply does not react to an increase in demand, prices will increase (a new equilibrium).
  - This will lead to inflation.
- **Unemployment:**
  - Demand-side policies are effective in stimulating economic growth.
  - The demand for labour will increase due to economic growth, and that leads to reduced unemployment.
  - A decrease in unemployment results in an increase in inflation because more people are employed, which causes an increase in demand for labour.
  - This relationship between unemployment and inflation can be illustrated by the Phillips curve.
2.3.4B Supply-side policies
Supply-side policies include:

- **Reduction of costs**
  - Infrastructural services
  - Administrative costs
  - Cash incentives

- **Improving the efficiency of inputs**
  - Tax rates
  - Capital consumption
  - Human resources development
  - Free advisory services

- **Improving the efficiency of markets**
  - Deregulation
  - Competition
  - Levelling the playing field

2.4 Features used in forecasting business cycles

There are many economic indicators that can be used to forecast business cycles. Some of these are:

2.4.1. Leading indicators

- Leading indicators give consumers, businesses and the state a glimpse of the direction in which the economy might be heading.
- When these indicators rise, the level of economic activities will also rise a few months later.
- Examples of lending indicators are job advertising space; inventory; and sales.

2.4.2. Lagging indicators

- Lagging indicators won’t change direction until after the business cycle has changed its direction.
- Examples of these indicators are hours worked in construction and total of commercial vehicles sold.

2.4.3. Co-incident indicators

- Co-incident indicators move at the same time as the economy.
- They indicate the actual state of the economy.
- Examples of these indicators are value of retail sales and real GDP.

2.4.4. Trend

- The trend is the general direction of the economy.
- The trend line that rises gradually will be positively sloped in the long run. This rising line indicates a growing economy.
2.4.5. Length
• Length is measured from peak to peak or from trough to trough.
• Longer cycles show strength and shorter cycles show weakness with regard to economic activities.

2.4.6. Amplitude
• Amplitude refers to the vertical (height) difference between a trough and the next peak of a cycle.
• The larger the amplitude, the more extreme the changes that occur.

2.4.7. Extrapolation
• Extrapolation means to estimate something unknown from facts that are known. For example, extrapolations from known facts are used to predict future share prices.

2.4.8. Moving averages
• Moving averages are used to analyse the changes in a series of data over a certain period of time.

Leadind indicators show us where we’re heading
Lagging indicators won’t change direction
Co-incident indicators, together moving

What’s the trend? Show me the way
What’s the length? Weak or strong today

Pump up the amplitude to see the difference
I need to extrapolate to make my predictions

Activity 1
Study Graph 2.4 below and answer the questions that follow:

Graph 2.4 Business cycles
1. Define the term business cycle. (3)
2. Indicate which indicator is represented by T. (2)
3. What is measured by the horizontal axis? (2)
4. At which point did the economy reach a peak and a trough? (4)
5. Identify the four phases into which the business cycle is divided in the above illustration. (8)
6. How is the length measured in the above business cycle? (2)
7. Explain lagging and coincident indicators used in the forecasting of business cycles. (2 × 4) (8)

**Answers to activity 1**

1.1 Successive periods of growth and decline in economic activities✓✓✓ (3)
1.2 Trend line✓✓ (2)
1.3 Time✓✓ (2)
1.4 Peak – C✓✓
    Trough – E✓✓ (4)
1.5 BC – Prosperity✓✓
    CD – Recession✓✓
    DE – Depression✓✓
    EF – Recovery✓✓ (8)
1.6 From C to G ✓✓ or E to I ✓✓ (2)
1.7 **Lagging indicators**
    These do not change direction until after the business cycle has changed its direction. ✓✓
    E.g. hours worked in construction; total number of commercial vehicles sold✓✓

**Co-incident indicators**

    These move at the same time as the economy ✓✓
    They indicate the actual state of the economy✓✓
    E.g. value of retail sales; real GDP (8)

**Activity 2**

Study the cartoon below and answer the questions that follow:

*Source: Mail & Guardian, 2010*
1. What is the message behind the cartoon? (2)

2. Why do you think that unemployment will not lead to an economic lift off? (2)

3. To which forecasting does unemployment refer to? (2)

4. How would you describe the recovery phase of a typical business cycle? (2)

**Answers to activity 2**

2.1 Illustrate the business cycle struggling to recover due to the burden of unemployment (2)

2.2 Due to a high percentage of unemployed people in South Africa. (2)

2.3 Co-incident. (2)

2.4 Economic activities start to increase OR
   - Exports will start to increase, resulting in an increase in production (2)

**Activity 3**

Discuss the monetarist approach as a cause of business cycles. [8]

**Answers to activity 3**

- Also called the sunspot theory / exogenous approach
- Believe markets are inherently stable.
- Departures from the equilibrium state are caused by factors outside of the market system.
- Market forces (supply and demand) kick in and bring the economy back to its natural state or equilibrium route.
- These interferences are not part of the normal forces operating in the market.
- Governments should not interfere in the markets.
- Major cause of economic fluctuations are inappropriate government policies undesirable increases and decreases in money supply weather conditions shocks (September 11) structural changes severe increases in the price of fuel and wars

(maximum 4 marks for examples) [8]
Activity 4

Discuss the trend line in the forecasting of business cycles. [8]

Answers to activity 4

- The trend line represents the average position of a cycle. ✔✔
- It indicates the general direction in which the economy is moving. ✔✔
- An upward trend suggests that the economy is growing. ✔✔
- The trend line usually has a positive slope, because production capacity increases over time. ✔✔
- Diagram showing trend line (see Graph 2.1 on page 16 for an example). ✔✔
- Accept any other relevant facts ✔✔ (any 4 x 2)

Below is a list of suggested past exam questions for extra practice:

- Business cycles – February 2010, question 2.1.2
- Business cycles – November 2011, question 1.1.2
- Business cycles – February 2011, question 1.1.1
- Exogenous and endogenous business cycles – February 2010, question 6.4
- The trend line – November 2010, question 1.1.1
- Economic indicators – November 2010, question 2.2
- The monetarist approach – November 2010, question 2.6
- Inflation – February 2011, question 2.1.2
- Employment – February 2011, question 2.1.3
- The endogenous approach – November 2011, question 2.5

CHAPTER 2 essay practise (Question 7):

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Write an essay by briefly analysing the composition and features of business cycles and explain how authorities use certain policies to smooth out business cycles. (Feb/March 2009)
- Explain, with the aid of an appropriately labelled diagram, how the various business cycle indicators can be used in forecasting. (November 2009)
The public sector, also known as the state or government, is responsible for providing certain goods and services to citizens. It also determines the policy regarding these goods and services at national, regional and local levels. The public sector is also involved in the delivery of social security, public facilities and policing.
3.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>The budget</td>
<td>A document that details expected revenue and projected expenditure</td>
</tr>
<tr>
<td>Bureaucrats</td>
<td>An official in a government department</td>
</tr>
<tr>
<td>Central national government</td>
<td>Concerned with national issues, e.g. safety and security</td>
</tr>
<tr>
<td>Collective goods</td>
<td>E.g. parks and public utilities. Free riders or people who do not want to pay can be excluded by levying fees</td>
</tr>
<tr>
<td>Community goods</td>
<td>E.g. police stations. Everyone can use these whether they are prepared to pay for them or not</td>
</tr>
<tr>
<td>Demerit goods</td>
<td>Harmful goods, e.g. cigarettes</td>
</tr>
<tr>
<td>Deregulation</td>
<td>Removal of unnecessary restrictions by law</td>
</tr>
<tr>
<td>Direct taxes</td>
<td>Taxes that are not shifted to the end user, e.g. PAYE</td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>Taxes levied on the sale of goods and services</td>
</tr>
<tr>
<td>Local government</td>
<td>Deals with local issues within a town or municipal area</td>
</tr>
<tr>
<td>Merit goods</td>
<td>Goods and services whose provision has more public benefit than private benefit, e.g. health</td>
</tr>
<tr>
<td>Monetary Policy Committee (of the Reserve Bank) (MPC)</td>
<td>Decides on the country's monetary policy</td>
</tr>
<tr>
<td>Medium Term Budget Policy Statement (MTBPS)</td>
<td>Government’s statement setting out its three-year budget</td>
</tr>
<tr>
<td>Medium Term Expenditure Framework (MTEF)</td>
<td>Estimates income and expenditure for a three-year period</td>
</tr>
<tr>
<td>Nationalisation</td>
<td>Transfer of functions and ownership from the private sector to the public sector</td>
</tr>
<tr>
<td>Public goods and services</td>
<td>Provided by the state for use by all the members of a society, e.g. public libraries</td>
</tr>
<tr>
<td>Regional government</td>
<td>Deals with economic and other issues specific to a region/province</td>
</tr>
<tr>
<td>Regulation</td>
<td>Putting laws in place to regulate activities</td>
</tr>
<tr>
<td>State Owned Enterprises (SOE)</td>
<td>A business owned wholly on partly by the state and run by a public authority, e.g Eskom and SAA</td>
</tr>
<tr>
<td>Value Added Tax (VAT)</td>
<td>An indirect tax on goods and services consumed in the economy</td>
</tr>
</tbody>
</table>
3.2 Problems of public sector provisioning

Learn these six problems of public sector provisioning:

3.2.1. Accountability

- **Government** is required to make and implement policies. Accountability is underpinned by ministerial responsibilities, parliamentary questioning, treasury control and the auditor-general.
- **Public servants** are required to give an explanation of their decisions and actions.
- **The public** holds government accountable for the effective delivery of services and the implementation of policies.

3.2.2. Efficiency

- **Efficient provisioning**: Public servants provide the public with goods and services promptly and in the desired quantity and quality.
- **Inefficient provisioning**: Public servants fail to deliver services to the public because of bureaucracy, incompetence and corruption.

3.2.3. Assessing of needs

- **Government provides** goods and services according to the needs of people.
- **Demand and supply** also shows the needs of consumers.
- **Market forces** determine the price of goods and services in the private sector.
- **State enterprises** are not subjected to the forces of demand and supply.

3.2.4. Pricing policy

- **Tax free**: Certain services are provided free of charge from taxes, e.g. public health services.
- **Price value**: Prices can be overvalued or undervalued.
- **Paid services**: People pay for services, e.g. TV licences.
- **Subsidised products**: The public pay less for goods because government subsidises (pays towards) the cost, e.g. the price of bread is subsidised by government.

3.2.5. Parastatals

- **State Owned Enterprises (SOEs)** are created as a result of nationalisation.
- **Service provisioning**: SOEs support service delivery, e.g. Eskom, SABC and Transnet.
• **Infrastructure provisioning**: SOEs provide essential infrastructure, especially when there are insufficient funds in the private sector, e.g. the road network.

• **Limited liability**: SOEs have limited liability in South Africa because they are financially supported by government.

### 3.2.6. Privatisation

- Privatisation refers to the **transfer of functions and ownership** from the public to the private sector.
- The aim of privatisation is to reduce the relative size of the public sector.
- **Advantages of privatisation**:
  - Privatisation stimulates growth and improves the overall efficiency and performance of the economy.
  - Privatisation provides additional funds to the government.
  - Privatisation attracts foreign investment.
3.3 Fiscal policy

3.3.1. The features and characteristics of fiscal policy

- **Goal bound**
  - Central government determines economic and social goals during the budgetary process.
  - The budget is used to realise these economic and social goals.

- **Demand biased**
  - Fiscal policy is the main demand-side policy.
  - The government improves infrastructure to support fiscal policy.

- **Cyclical**
  - Businesses have a direct effect on fiscal policy.
  - During an upswing profits increase, and as a result government income increases.

3.3.2. The composition of fiscal policy

The key instruments of fiscal policy are government spending and taxation (surplus and deficit).

In a balanced budget: The amounts are equal (when the projected revenue and expected expenditure are equal).

Fiscal policy consists of:

- Government spending
- Taxation
- State debt

3.3.3. The effects of fiscal policy

- **Income distribution**
  - **Progressive**: Fiscal policy ensures a more even distribution of income.
  - **Regressive**: Fiscal policy causes an uneven distribution of income.
  - **Proportional**: Fiscal policy results in income distribution remaining unchanged.

- **Consumption**
  - Direct and indirect taxes influence people’s spending patterns.
  - Minimal savings cause decreasing consumption.

- **Price level**
  - Direct tax reduces inflationary pressure.
  - A rise in indirect taxes will raise the general price level.

- **Disincentives**
  - High and progressive income tax rates discourage people from entering the labour market, from accepting promotions, and from working longer hours.
3.3.4. Introduction to the Laffer Curve

Graph 3.1 shows the relationship between tax rates and income tax in what is called the Laffer Curve.

Graph 3.1 The Laffer Curve

- The Laffer Curve shows the relationship between tax rates and income tax.
- At point 0, average income tax is 0 and income is 0.
- A tax rate increase above 0 will result in tax revenue increasing to a certain point.
- The curve will slope upward then peak at $T$.
- Peak tax revenue is at point $R$ and peak tax rate is at point $T$.
- The state earns maximum revenue at this point.
- If the tax rate increases from $T$ to $T_1$, production decreases from $R$ to $R_1$.
- Less people work as a result of higher tax.
- If taxation decreases to $T_2$, the government may receive less revenue for services, but people may have more money to save.
3.4 Reasons for public sector failure

Public sector failure occurs when the public sector fails to provide goods and services to the people. There are many reasons for public sector failure. Some of these are:

3.4.1. Management failure
Ignorance, e.g. lack of leadership, experience and training, might result in the improvement of the welfare of someone at the expense of someone else.

3.4.2. Apathy
Long-term accountability remains the cornerstone of successful public production. Corruption and poor service delivery are some of the symptoms.

3.4.3. Lack of motivation
Workers rarely receive incentives for successful service delivery, but are only monitored on inputs and correctly following procedures and processes. This might lead to limited services, high cost and low quality.

3.4.4. Bureaucracy
There are few rewards and little or no regulation to ensure service quality and quantity.

3.4.5. Structural weaknesses
Objectives are not met. Some objectives may work against each other, e.g. government redistributes income and wealth too aggressively.

3.4.6. Special interest groups
Attempts by interest groups such as farmers or organised labour to influence government to their own advantage.

Figure 1: Reasons for public sector failure
3.5 Effects of public sector failure

3.5.1 Allocation of resources
the public sector should counteract the market-provision incompatibility, but in failing to do so, optimal allocation of resources is not possible and are wasted.

3.5.2 Economic stability
this macroeconomic objective is achieved through fiscal and monetary policy, e.g. interest rates and employment.

3.5.3 Distribution of income
The progressive income tax system in South Africa, company taxes and wealth taxes should redistribute income and wealth.

3.5.4 Social stability
Free services (e.g. street lighting) and cash grants (child grants) are provided to the poor.

Failure to reach a positive outcome on these effects may lead to the opposite effect.

Activity 1
Study the following information in Figure 3.2 below: A news article on the National Budget 2012, and answer the questions that follow.

HOW MUCH IS GOING TO BE SPENT?

Over the long term, government aims to grow the economy so that all South Africans who wish to work can work. But given our history, it will take some time before we can reach this goal, and we urgently need to assist millions of South Africans who do not have access to an income, or who are otherwise vulnerable.

Poverty alleviation is at the heart of governments's agenda. The social assistance programme is South Africa’s most direct means of combating poverty. In 2012/13, R104.9 billion is allocated to social assistance, rising to R122.0 billion in 2014/15. The number of grant recipients will rise from about 15.6 million in 2011/12 to 16.1 million in 2012/12 and is set to rise to 16.8 million in 2014/15.

The Isibindi project will benefit 858 000 children and adolescents, with a focus on rural communities, orphans and child-headed households. About 10 000 youth workers will be employed in this programme.

The Department of Social Development receives an additional R1.4 billion over the next three years, mainly to increase access to early child development from 50 000 to 580 000 and to roll out an in-house and community-based childcare and protection programme (Isibindi).

Figure 3.2: A news article on the National Budget 2012
1. To which economic concept does “Improving the quality of life...” refer to? (2)

2. From the extract, name TWO macroeconomic aims (objectives) reflected in the 2011/12 Budget. (2 × 2) (4)

3. Which THREE departments received the largest allocation according to the graph? (3 × 2) (6)

4. Give TWO reasons why government spent more on education in 2012 than last year. (4)

5. Name TWO priorities that are included in the money allocated for social protection. (2 × 2) (4)

**Answers to activity 1**

1. Economic development✓✓
2. Job creation✓✓ and economic growth✓✓
3. Education✓✓ Social protection✓✓ Administration✓✓
4. Infrastructure development✓✓ and increase in educators salaries✓✓
5. Poverty relief✓✓ and skills development for orphans✓✓

**Activity 2**

Classify each of the following activities according to CENTRAL/NATIONAL; PROVINCIAL; LOCAL GOVERNMENT and PUBLIC CORPORATIONS.

1. Traffic control (1)
2. Denel (1)
3. SABS (1)
4. Inflation target (1)
5. Telkom (1)
6. RDP housing (1)
7. Education (1)

**Answers to activity 2**

1. Traffic control – Local✓
2. Denel – Public corporation✓
3. SABS – Public corporation✓
4. Inflation target – Central/National✓
5. Telkom – Public✓
6. RDP housing – Provincial✓
7. Education – Central/National✓✓
Below is a list of suggested past exam questions for extra practice:

- **Public goods (2 marks)** - February 2010, question 1.1.1
- **Laffer curve (2 marks)** - February 2010, question 2.1.3
- **Privatisation (6 marks)** - February 2010, question 2.2
- **Inefficiency – problem of public sector (2 marks)**, question 2.4
- **Parastatals (2 marks)** - February 2011, question 1.1.2
- **Public sector failure (2 marks)** - February 2011, question 2.1.4
- **Budget (data base – 10 marks)** - February 2011, question 2.3
- **Public sector failure (8 marks)** - February 2011, question 2.6
- **Levels of public sector (2 marks)** - November 2010, question 1.1.2
- **Social Services (2 marks)** - November 2010, question 1.3.1
- **Fiscal policy (2 marks)** - November 2010, question 2.1.2
- **Privatisation (2 marks)** - November 2010, question 2.1.3
- **Necessity & macroeconomic objectives of government (50 marks)** - November 2010, question 7
- **Social services (2 marks)** - November 2011, question 2.1.4
- **Community goods (6 marks)** - November 2011, question 2.2
- **Fiscal policy (data base 10 marks)** - November 2011, question 2.4
- **Public sector failure (8 marks)** - November 2011, question 6.5

**CHAPTER 3 essay practise**

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Discuss the necessity of the public sector and the macroeconomic objectives of the government in detail. (November 2010)
- Discuss the problems of public sector provisioning. (February/March 2012)
Chapter 4

THE FOREIGN EXCHANGE MARKET AND THE BALANCE OF PAYMENTS ACCOUNTS

The foreign exchange market (currency market) is an exchange market which determines the relative values of different currencies, and enables the conversion of currency to facilitate international trade.

The balance of payments (BoP) accounts record all financial transactions between a country and the rest of the world over a period of a year. They include export and import transactions, financial transfers and financial capital transactions.

### 4.1 Key concepts

#### 4.1.1. Exchange rate systems
- **Free floating exchange rates**
- **Controlled exchange rates**
- **Fixed exchange rate**

#### 4.1.2. Appreciation and depreciation

#### 4.1.3. Factors influencing the supply and demand of foreign exchange

#### 4.1.4. Correcting disequilibria in the balance of payments

### 4.2 The reasons for international trade

- **Demand reasons**
- **Supply reasons**
- **The effects of international trade**

### 4.3 The balance of payments accounts

- **4.3.1. The current account**
- **4.3.2. The capital transfer account**
- **4.3.3. The financial account**
- **4.3.4. The reserve account**

### 4.4 Exchange rate systems

- **4.4.1. Free floating exchange rates**
- **4.4.2. Controlled exchange rates**
- **4.4.3. Fixed exchange rate**
- **4.4.4. Appreciation and depreciation**
- **4.4.5. Factors influencing the supply and demand of foreign exchange**
- **4.4.6. Correcting disequilibria in the balance of payments**
### 4.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute advantage</td>
<td>Where one country can produce goods or services cheaper than another</td>
</tr>
<tr>
<td>Balance of payments</td>
<td>A systematic record of all transactions between one country and other countries, e.g. between South Africa and all other countries in the world</td>
</tr>
<tr>
<td>Direct investment</td>
<td>Includes transactions relating to investment, e.g. investments in businesses</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>The rate at which one currency is exchanged for another. It is also considered the value of one country’s currency in terms of another country’s currency.</td>
</tr>
<tr>
<td>Free trade</td>
<td>When consumers and producers are free to buy goods and services anywhere in the world without any restrictions</td>
</tr>
<tr>
<td>International Monetary Fund (IMF)</td>
<td>Lends money to countries with an ongoing balance of payment problems</td>
</tr>
<tr>
<td>International trade</td>
<td>The exchange of goods or services across international borders</td>
</tr>
<tr>
<td>Net balance</td>
<td>Money that enters the country is offset against money that leaves the country</td>
</tr>
<tr>
<td>Portfolio investment</td>
<td>Buying and selling equities and debt securities, e.g. shares and bonds</td>
</tr>
<tr>
<td>Relative cost advantage</td>
<td>One country produces goods more cheaply because of various cost factors</td>
</tr>
<tr>
<td>Special Drawing Rights (SDR)</td>
<td>A financing instrument distributed among member countries of the IMF</td>
</tr>
</tbody>
</table>
| Terms of trade                | Compares a country’s export prices with its import prices by means of indexes. The formula used to determine the terms of trade is: index of export prices \( \times \) 100  
\( \frac{\text{Index of import prices}}{\text{Index of export prices}} \)  
The terms of trade will improve when export prices increase of import prices decrease. |
| Trade balance                 | The value of exports minus imports                                                                                                                                                                          |
| Transfer payment              | Money received without any productive service rendered, e.g. gifts                                                                                                                                          |
4.2 The reasons for international trade

There are many reasons for international trade. Countries may have a surplus of some goods and a shortage of other goods, and they will trade in order to correct these imbalances. For example, South Africa has more minerals than it can use, but less oil than it needs. Certain goods are only produced in specific countries (e.g. French champagne) and the citizens of other countries may desire access to those goods. Droughts can severely damage the production of staple crops in a country resulting in the need to import crops to feed the population.

4.2.1. Demand reasons

- **The size of the population impacts demand.** If there is an increase in population growth, it causes an increase in demand, as more people’s needs must be satisfied. Local suppliers may not be able to satisfy this demand.
- **The population’s income levels effect demand.** Changes in income cause a change in the demand for goods and services. An increase in the per capita income of people results in more disposable income that can be spent on local goods and services, some of which may then have to be imported.
- **An increase in the wealth of the population leads to greater demand for goods.** People have access to loans and can spend more on luxury goods, many of which are produced in other countries.
- **Preferences and tastes** can play a part in the determining of prices, e.g. customers in Australia have a preference for a specific product which they do not produce and need to import, and it will have a higher value than in other countries.
- **The difference in consumption patterns** is determined by the level of economic development in the country, e.g. a poorly developed country will have a high demand for basic goods and services but a lower demand for luxury goods.

4.2.2. Supply reasons

- **Natural resources** are not evenly distributed across all countries of the world. They vary from country to country and can only be exploited in places where these resources exist.
- **Climatic conditions** make it possible for some countries to produce certain goods at a lower price than other countries, e.g. Brazil is the biggest producer of coffee.
- **Labour resources** differ in quality, quantity and cost between countries. Some countries have highly skilled, well-paid workers with high productivity levels, e.g. Switzerland.
- **Technological resources** are available in some countries that enable them to produce certain goods and services at a low unit cost, e.g. Japan.
• **Specialisation** in the production of certain goods and services allows some countries to produce them at a lower cost than others, e.g. Japan produces electronic goods and sells these at a lower price.

• **Capital** allows developed countries to enjoy an advantage over under-developed countries. Due to a lack of capital, some countries cannot produce all the goods they require themselves.

### 4.2.3. The effects of international trade

• **Specialisation** increases the standard of living, especially when the area of specialisation is in great demand due to a shortage of supply, e.g. Angola has oil so it can specialise in oil products. Mozambique has no oil resources and cannot specialise in these resources.

• **Mass production** becomes possible if the domestic demand is added to foreign demand, e.g. manufacturing of cell phones.

• **Efficiency** increases when there is competition. Lower prices mean that the same income can buy more goods and services.

• **Globalisation** is driven by international trade, e.g. trade in IT products and vehicles (cars and trucks).
4.3 The balance of payments accounts

Each country keeps a record of all its import and export transactions with the rest of the world. This record is called the balance of payments (BoP). A country may be said to have a BoP surplus if the source of their funds (exports, etc.) exceeds their use of such funds. A BoP deficit would occur when the use of funds is greater than the funds received (from exports, etc.).

We will look at the different accounts that form part of the balance of payments:

4.3.1 The current account
The balance of the current account is an indication of whether the country can afford its day to day transactions.

4.3.2 The capital transfer account
The balance shown reflects the net amount of the capital transfer, either negative or positive.

4.3.3 The financial account
Records all international transactions in assets and liabilities are recorded.

4.3.4 The reserve account
South Africa’s balance of gold and foreign exchange reserves are not shown in the balance of payment account – this represents stock. Only the changes to the gold and foreign reserves are shown.

Table 4.1 shows the latest available balance of payments from the Quarterly Bulletin from the South African Reserve Bank. You should be able to make certain assumptions from the data given, for example:
• Determine whether there was a surplus or deficit in one of the accounts
• Identify possible reasons for funds flowing out of or into the country
Table 4.1 Balance of payments  
Quarterly Bulletin March 2012

<table>
<thead>
<tr>
<th>Current account</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchandise exports, free on board</td>
<td>281 827</td>
<td>311 338</td>
<td>412 220</td>
<td>497 618</td>
<td>655 759</td>
<td>503 656</td>
<td>565 860</td>
<td>671 220</td>
</tr>
<tr>
<td>Net gold exports</td>
<td>28 698</td>
<td>27 023</td>
<td>35 470</td>
<td>39 898</td>
<td>48 534</td>
<td>52 776</td>
<td>59 499</td>
<td>75 298</td>
</tr>
<tr>
<td>Service receipts</td>
<td>63 425</td>
<td>71 808</td>
<td>82 643</td>
<td>97 110</td>
<td>105 510</td>
<td>100 760</td>
<td>102 362</td>
<td>107 825</td>
</tr>
<tr>
<td>Income receipts</td>
<td>20 973</td>
<td>29 550</td>
<td>41 207</td>
<td>48 448</td>
<td>48 254</td>
<td>34 075</td>
<td>34 999</td>
<td>38 118</td>
</tr>
<tr>
<td>Less: Merchandise imports, free on board</td>
<td>311 759</td>
<td>360 362</td>
<td>476 966</td>
<td>573 850</td>
<td>739 852</td>
<td>554 161</td>
<td>598 151</td>
<td>730 128</td>
</tr>
<tr>
<td>Less: Payments for services</td>
<td>66 420</td>
<td>77 197</td>
<td>96 623</td>
<td>115 934</td>
<td>138 885</td>
<td>124 147</td>
<td>134 843</td>
<td>142 230</td>
</tr>
<tr>
<td>Change in gross gold and other foreign reserves</td>
<td>84 823</td>
<td>60 975</td>
<td>75 982</td>
<td>117 266</td>
<td>122 129</td>
<td>87 593</td>
<td>87 022</td>
<td>104 689</td>
</tr>
<tr>
<td>Current transfers (net receipts +)</td>
<td>-10 869</td>
<td>-15 680</td>
<td>-15 768</td>
<td>-16 575</td>
<td>-18 906</td>
<td>-22 428</td>
<td>-16 762</td>
<td>-14 199</td>
</tr>
<tr>
<td>Balance on current account</td>
<td>-42 948</td>
<td>-54 495</td>
<td>-93 799</td>
<td>-140 551</td>
<td>-161 874</td>
<td>-97 062</td>
<td>-74 958</td>
<td>-98 785</td>
</tr>
<tr>
<td>Capital transfer account (net receipts +)</td>
<td>338</td>
<td>193</td>
<td>205</td>
<td>197</td>
<td>208</td>
<td>216</td>
<td>225</td>
<td>241</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial account</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td>5 155</td>
<td>42 270</td>
<td>-3 567</td>
<td>40 120</td>
<td>74 403</td>
<td>45 465</td>
<td>8 993</td>
<td>42 168</td>
</tr>
<tr>
<td>Assets</td>
<td>-8 721</td>
<td>-5 916</td>
<td>-41 058</td>
<td>-20 896</td>
<td>25 888</td>
<td>-9 757</td>
<td>554</td>
<td>4 610</td>
</tr>
<tr>
<td>Net direct investment</td>
<td>-3 566</td>
<td>36 354</td>
<td>-44 625</td>
<td>19 224</td>
<td>100 291</td>
<td>35 708</td>
<td>9 547</td>
<td>46 778</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Portfolio investment</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td>46 262</td>
<td>36 188</td>
<td>144 501</td>
<td>97 485</td>
<td>-71 540</td>
<td>107 876</td>
<td>46 976</td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>-5 946</td>
<td>-6 123</td>
<td>-15 044</td>
<td>-24 026</td>
<td>-63 325</td>
<td>-14 470</td>
<td>-33 374</td>
<td>-44 474</td>
</tr>
<tr>
<td>Net portfolio investment</td>
<td>40 316</td>
<td>30 065</td>
<td>129 457</td>
<td>73 459</td>
<td>-134 865</td>
<td>74 764</td>
<td>2 502</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other investment</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td>10 944</td>
<td>32 735</td>
<td>60 750</td>
<td>58 711</td>
<td>47 730</td>
<td>-39 956</td>
<td>7 899</td>
<td>31 696</td>
</tr>
<tr>
<td>Assets</td>
<td>-3 555</td>
<td>-22 895</td>
<td>-38 823</td>
<td>2 119</td>
<td>82 983</td>
<td>23 703</td>
<td>-22 138</td>
<td>-3 611</td>
</tr>
<tr>
<td>Net other investment</td>
<td>7 389</td>
<td>9 840</td>
<td>21 927</td>
<td>60 830</td>
<td>130 713</td>
<td>-16 253</td>
<td>-14 239</td>
<td>28 085</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance on financial account</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrecorded transactions</td>
<td>35 999</td>
<td>12 306</td>
<td>16 627</td>
<td>34 657</td>
<td>91 593</td>
<td>664</td>
<td>36 229</td>
<td>53 883</td>
</tr>
</tbody>
</table>

| Change in net gold and other foreign reserves owing to balance-of-payments transactions | 37 528 | 34 263 | 29 792 | 47 816 | 26 066 | 17 037 | 31 306 | 32 704 |

| Change in liabilities related to reserves | 2 949 | 2 577 | -5 453 | -7 631 | -7 761 | -2 724 | -2 683 | 7 |

| SDR allocations and valuation adjustments | -10 617 | 11 003 | 23 350 | 5 642 | 74 214 | -38 647 | -30 712 | 7 441 |

| Net monetisation(+)/demonetisation(-) of gold | 84 | -226 | 163 | 169 | 158 | 45 | 13 | 42 |

| Change in gross gold and other foreign reserves | 29 944 | 47 617 | 47 852 | 45 996 | 92 677 | -24 289 | -2 076 | 107 194 |

| Memo item: Change in capital transfer and financial accounts including unrecorded transactions | 80 476 | 88 758 | 123 591 | 188 367 | 187 940 | 114 099 | 106 264 | 131 489 |
4.4 Exchange rate systems

Every country manages the value of its currency by determining the exchange rate system that will apply to its currency. There are numerous exchange rate systems. Among these are:

4.4.1. Free floating exchange rates
The value of the currency is determined purely by the forces of the market, i.e. demand for rand and supply of rand.

4.4.2. Controlled exchange rates
These are exchange rates which are allowed to respond to market forces within certain limits.

4.4.3. Fixed exchange rates
Currencies are devaluated and revaluated. The gold standard backed the value of the currency to a certain amount of gold. South Africa stepped off the gold standard in 1932.

4.5 Foreign exchange markets
This market engages in the buying and selling of foreign exchange.

A demand for dollars exists when, for example, South African importers wish to exchange rands for dollars to pay for goods/services to be imported from the United States of America.

On the other hand, the holders of dollars seek to exchange dollars for rands when, for example, the American importer wants to pay for goods/services to be imported from South Africa.

There might be an excess supply or excess demand for dollars when the price rises above or falls below the market price of OP (see Graph 4.1).

Graph 4.1: The interaction of demand and supply in establishing the rate of exchange

4.5.1. Appreciation and depreciation

Appreciation of a currency is an increase in the price of the currency in terms of another currency due to market forces.

Depreciation of a currency is a decrease in the price of the currency in terms of another country’s currency due to market forces.
Chapter 4 The foreign exchange market and the balance of payments accounts
4.5.2. Factors influencing supply and demand of foreign exchange

<table>
<thead>
<tr>
<th>Demand for foreign exchange</th>
<th>Supply of foreign exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Importing goods</td>
<td>• Exporting goods</td>
</tr>
<tr>
<td>• Payment for services from foreign countries</td>
<td>• Providing services to foreign countries</td>
</tr>
<tr>
<td>• Buying shares in another country</td>
<td>• Receiving dividends on shares invested in foreign countries</td>
</tr>
<tr>
<td>• Tourists spending money overseas</td>
<td>• Inflow of foreign capital</td>
</tr>
<tr>
<td>• Repayment of debt borrowed from foreign countries</td>
<td>• Expenditure of money by foreign tourists</td>
</tr>
<tr>
<td></td>
<td>• Raising new loans in foreign countries</td>
</tr>
</tbody>
</table>

4.5.3. 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

**Activity 1**

Study Graph 4.2 concerning international trade and answer the questions that follow.
1. What does graph 1 depict? Supply a reason for your answer. (2)

2. Define the term balance of trade. (3)

3. Does the balance of trade in 2008 indicate a positive or a negative balance? (2)


5. What effect did the closing of the textile factories in South Africa have on the balance of trade? (3)

6. Which economic trend in 2009 contributed to the decline in imports and exports? (2)

Answers to activity 1

1. It depicts the difference between the imports and exports.✓✓ (2)

2. It is the value of exports minus the value of imports.✓✓✓ (3)

3. Negative balance✓✓ (2)

4. 600 000 – 700 000✓✓ = –100 000✓✓ (2)

5. A negative effect✓ because there was an increase in imports✓✓ (3)

6. Global recession✓✓ (2)

Activity 2

Study Table 4.2 which shows the balance of payments extract and answer the questions that follow:

<table>
<thead>
<tr>
<th>BALANCE OF PAYMENT – ANNUAL FIGURES</th>
<th>2009</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of current account</td>
<td>-97 062</td>
<td>-98 785</td>
</tr>
<tr>
<td>Capital transfer account (net receipts)</td>
<td>216</td>
<td>241</td>
</tr>
<tr>
<td><strong>Financial Account:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct investment (net)</td>
<td>35 708</td>
<td>B</td>
</tr>
<tr>
<td>Portfolio investment (net)</td>
<td>93 764</td>
<td>2 502</td>
</tr>
<tr>
<td>Other investment (net)</td>
<td>-16 253</td>
<td>28 085</td>
</tr>
<tr>
<td>Balance on financial account</td>
<td>A</td>
<td>77 365</td>
</tr>
<tr>
<td>Unrecorded transactions</td>
<td>664</td>
<td>53 883</td>
</tr>
<tr>
<td>Change in gross gold and other foreign reserves</td>
<td>-24 289</td>
<td>107 194</td>
</tr>
</tbody>
</table>


Table 4.2 Balance of payments for 2009–2011

1. Define the concept balance of payments. (2)

2. Calculate the missing figures in A and B. (4)

3. What does ‘net figures’ indicate in the financial account? (2)
4. Give TWO examples of income receipts earned by South African residents. (4)

5. Briefly explain how balance of payments disequilibria can be corrected. (6)

---

**Answers to activity 2**

1. This is a systematic record of all transactions between one country, e.g. South Africa and all other countries in the world.✓✓ (2)

2. A = R113 219 million✓✓ B = R46 778 million✓✓ (4)

3. Money that enters the country is offset against money that leaves the country.✓✓ (2)

4. Services abroad, e.g. sportsmen✓✓ and professional services✓✓ (4)

5. • Borrowing money from the IMF✓✓
• Policies of export promotion and import substitution✓✓
• Increase in aggregate supply will reduce prices. Exports are promoted through cheaper prices.✓✓
• Higher interest rates help to decrease spending on imports.✓✓ (any 3) (6)

---

**Exams**

Below is a list of suggested past exam questions for extra practice:

- Demand for foreign exchange (2 marks) - February 2010, question 1.1.3
- Foreign exchange (2 marks) - February 2010, question 1.3.8
- Foreign exchange markets (2 marks) - February 2010, question 6.1.4
- Balance of Payments accounts (50 marks) - February 2010, question 7
- Comparative advantage (2 marks) - February 2011, question 2.1.1
- Demand for foreign exchange (6 marks) - February 2011, question 2.2
- Balance of Payments (data base 10 m) - February 2011, question 2.4
- Foreign currencies (2 marks) - February 2011, question 6.1.1
- International trade (6 marks) - February 2011, question 6.2
- Disequilibrium in Balance of Payments (8 marks) - February 2011, question 6.6
- Balance of Payments (2 marks) - November 2010, question 2.1.4
- Demand and supply of foreign exchange (graph – 10 marks) - November 2010, question 2.3
- Terms of trade (calculation – 10 marks) - November 2010, question 2.4
- Devaluation (2 marks) - November 2011, question 1.1.3
- Disequilibrium (2 marks) - November 2011, question 1.2.3
- Terms of trade (2 marks) - November 2011, question 2.1.3
- Supply reasons for international trade (data base 10 marks) - November 2011, question 2.3

**CHAPTER 4 essay practise (Question 7):**

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Analyse the components of the balance of payments and suggest ways in which the government can correct a sustained deficit. (Feb/March 2010)
- Discuss the main supply reasons for international trade. (November 2011)
A perfect market is characterised by perfect competition. The conditions that result in perfect competition include:

- Equal access to the technology required for production. No barriers to entry or exit from the marketplace
- Accurate and available market information
- No participant with the power to set the market price
- According to general equilibrium theory, a perfect market will reach an equilibrium in which supply for every product or service, including labour, equals demand at the current price.

### THE DYNAMICS OF PERFECT MARKETS

#### 5.1 Key concepts
- Competition policy
- The conditions of a perfect market

#### 5.2 Perfect competition

#### 5.3 Market structures

#### 5.4 How to draw graphs
- Draw your two axes
- Determining the market price
- Determining maximum profit/equilibrium/profit maximisation
- Determining the economic profit for the individual firm
- Calculating the normal profit
- Calculating the economic loss
- Calculating the shutdown point and the break-even point
5.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Different market structures</td>
<td></td>
</tr>
<tr>
<td>1. Perfect competition</td>
<td>A market structure with large numbers of producers and buyers</td>
</tr>
<tr>
<td>2. Monopolistic competition</td>
<td>A market structure in which businesses have many competitors, but each one sells a slightly different product (e.g. CD’s and books)</td>
</tr>
<tr>
<td>3. Oligopoly</td>
<td>A market structure controlled by a small group of businesses</td>
</tr>
<tr>
<td>4. Monopoly</td>
<td>Exclusive control of a commodity or service in a particular market</td>
</tr>
<tr>
<td>Explicit cost</td>
<td>Actual expenditure of business, e.g. wages and interest</td>
</tr>
<tr>
<td>Implicit cost</td>
<td>Value of inputs owned by entrepreneur and used in the production process (forfeited rental, interest + salary)</td>
</tr>
<tr>
<td>Market</td>
<td>An institution or mechanism that brings together buyers and sellers of goods or services</td>
</tr>
<tr>
<td>Market structure</td>
<td>How a market is organised</td>
</tr>
</tbody>
</table>

Use mobile notes to help you learn these concepts. Instructions for making them are on page xi in the introduction.
5.2 Perfect competition

Perfect competition occurs in a market structure with a large number of participants who have access to all required information about the marketplace and are all price-takers. Examples of market structures demonstrating perfect competition include the stock exchange, the foreign exchange market, the central grain exchange, and agricultural produce markets.

5.2.1. Competition policy

- Markets operate under healthy competition.
- Competition policy aims to prevent abuse of economic power, regulate growth of market power and prevent restrictive practices.
- The Competition Act 89 of 1998 as amended, makes provision for:
  - The Competition Commission: It tries to ensure all South Africans have equal opportunities to participate fairly in economic activities to make the economy efficient.
  - The Competition Tribunal: It submits recommendations to the Competition Commission which can either accept or reject its recommendations. If there are any disputes over the recommendations, they are referred to the Competition Appeal Court.

• Perfect competition occurs in a market structure with a large number of participants who are all price-takers, i.e. none of them can set the market price. There are no entry or exit barriers to the marketplace, all required information with regard to the marketplace is available to both buyers and sellers, and the products sold are homogenous.

5.2.2. The conditions of a perfect market

- A large numbers of buyers and sellers: No individual can influence the market price.
- Products are homogenous: Their quality and appearance are the same, and the price and quality will be the same wherever you buy or sell the product.
- There is complete freedom of entry and exit: The market is fully accessible and there are no legal, financial, technological or other restrictions to entry or exit from the market.
- The factors of production are completely mobile: They can move freely between markets.
- Buyers and sellers have full and accurate information on the market conditions: This knowledge allows them to switch their purchasing to other businesses.
- Collusion between sellers does not occur: Each seller acts independently.
- Government intervention does not occur: This ensures buyers and sellers have freedom to trade.
5.3 Market structures

There are FOUR different market structures:
- Perfect competition
- Monopolistic competition
- Oligopoly
- Monopoly

Table 5.1 shows the characteristics of these four market structures:

<table>
<thead>
<tr>
<th></th>
<th>Perfect competition</th>
<th>Monopolistic competition</th>
<th>Oligopoly</th>
<th>Monopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Examples</td>
<td>International commodity markets, e.g. gold and oil</td>
<td>Fast-food outlets</td>
<td>Petrol and oil markets</td>
<td>Eskom</td>
</tr>
<tr>
<td>Number of businesses</td>
<td>Enough that a single business cannot influence the market price</td>
<td>A very large number</td>
<td>So few that each business must take the actions of the others into account</td>
<td>One business</td>
</tr>
<tr>
<td>Nature of product</td>
<td>Homogenous (same kind)</td>
<td>Differentiated, e.g. cool drinks</td>
<td>Homogenous or differentiated</td>
<td>Unique product without any close substitutes</td>
</tr>
<tr>
<td>Market entry</td>
<td>Completely free</td>
<td>Free</td>
<td>From free to restricted</td>
<td>Blocked</td>
</tr>
<tr>
<td>Control over price</td>
<td>None</td>
<td>Few</td>
<td>Considerable, but less than with a monopoly</td>
<td>Considerable</td>
</tr>
<tr>
<td>Information</td>
<td>Complete</td>
<td>Incomplete</td>
<td>Incomplete</td>
<td>Complete</td>
</tr>
<tr>
<td>Demand curve</td>
<td>Market demand curve slopes from left to right – individual demand curve is horizontal</td>
<td>Downward sloping</td>
<td>Downward sloping</td>
<td>Downward sloping and equals the market demand curve</td>
</tr>
<tr>
<td>Long-term economic profit</td>
<td>Normal profit</td>
<td>Normal profit</td>
<td>Positive</td>
<td>Positive</td>
</tr>
<tr>
<td>Seller market power</td>
<td>None (price-taker)</td>
<td>Some</td>
<td>A whole lot</td>
<td>Many (price-maker)</td>
</tr>
<tr>
<td>Technical efficiency</td>
<td>Yes</td>
<td>Close</td>
<td>Possible</td>
<td>Possible</td>
</tr>
<tr>
<td>Allocative efficiency</td>
<td>Yes</td>
<td>Close</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Table 5.1 The characteristics of different market structures
5.4 How to draw graphs

5.4.1. Draw your two axes
First draw your TWO axes: Price (P) on the vertical axis and Quantity (Q) on the horizontal axis. Remember, they meet at the origin (0). Everything is important – do not leave out anything! Each step counts for marks. Label all axes, curves and graphs.

![Graph](image1)

Figure 1

5.4.2. Determining the market price
To determine the market price you must draw two graphs next to each other. On the left hand side you will find the graph for the industry, and on the right hand side you will find the graph for the individual producer. Look at the graph for the industry (Figure 2):

- On this graph there are the two market forces: demand and supply.
- The two market forces meet at point E (equilibrium). Show point E on the graph. This is the point where demand and supply are the same. This also determines the market price. In the perfect market we find many consumers and producers.
- Now look at the graph for the individual producer on the right hand side (Figure 3). One producer will therefore not influence the market price (he is a price-taker). He takes the market price – it becomes his demand curve and represents also the average revenue curve and marginal revenue curve.
- For the individual consumer, the two revenue curves (marginal revenue [MR] and average revenue [AR]) use exactly the same line as the market price (P') as well as the demand curve (dd) of the individual producer (see Figure 3).

![Graph](image2)

Figure 2: Graph for the industry

![Graph](image3)

Figure 3: Graph for the individual producer

Read this section on graphs through five times, and redraw each graph each time.
5.4.3. Determining maximum profit/equilibrium/profit maximisation

- Once again draw the graph for the market/industry, clearly showing where DD and SS meet.
- The graph on the right hand side (Figure 5) represents the individual firm.
- Remember: The market price is fixed at \( P_1 \) (because the individual producer is a price-taker). Indicate next to the line MR (marginal revenue) and AR (average revenue).
- To determine profit or loss, the business must combine the income and cost items on one graph.
- The marginal cost curve (MC) intersects the average cost curve (AC) at its minimum point. (This is just to draw your graph correctly).
- The individual firm will reach maximum profit where \( MC = MR \). \((\text{PLEASE encircle both the MC and MR as shown on the graph.})\)
- Point of intersection of \( MC = P = MR \) at point \( e \).

\[ \begin{align*}
\text{Price} & \quad D & \quad S \\
& \quad P_1 \\
\text{Quantity} & \quad O & \quad Q_e & \quad q_1 & \quad q_2
\end{align*} \]

Figure 4: Graph for the market/industry  
Figure 5: Graph for the individual firm

- At quantity \( q_1 \), the business will reach its optimum production point. Any point to the right will mean that the MC (cost) for that unit is more than the MR (revenue). The business will not increase its production to the right of \( q_1 \). It will also not stop producing before it reaches \( q_1 \), because it has not reached its maximum profit.
5.4.4. Determining the economic profit for the individual firm

- In the case of economic profit, the minimum point of the AC curve will be below the market price ($P_1$).
- Once again: make sure that you encircle MC and MR on your graph (see Figure 6). Their point of intersection indicates the profit maximisation point (e).
- Lengthen this point down to the quantity axis (point $Q_1$). Where it intersects the AC curve indicates the cost to the individual firm (point C on the price axis).
- You must be able to determine the total income, total cost and be able to determine the economic profit:

\[
\text{Total Income} = \text{Price} \times \text{Quantity} = P_1 \times Q_1
\]

\[
\text{Total Cost} = \text{Cost} \times \text{Quantity} = C \times Q_1
\]

\[
= \text{area of OP}_1\text{eQ}_1 = \text{area of OCMQ}_1
\]

- To determine the economic profit, you have to subtract your total cost from your total income: = area of CP$_1$eM (shaded area)
- You can use figures to do the same calculation:
  Income = $10 \times 7 = 70$
  Cost = $8 \times 7 = 56$
  Economic profit = $70 - 56 = 14$

\[\text{Figure 6}\]

\[\text{Figure 7}\]
5.4.5. Calculating the normal profit

- By now you are able to discuss how to determine the maximum profit. Use the same discussion when you are required to discuss this graph (Figure 8).
- When a business makes a normal profit, it seems as if its income and costs are equal. In actual fact, this is not true, as the salary of the entrepreneur is included in the total cost. That is why normal profit is described as the minimum remuneration an entrepreneur would be willing to receive, rather than closing the business.
- Income = cost = the area OP\textsubscript{1}eQ\textsubscript{1}

![Figure 8](image)

5.4.6. Calculating the economic loss

- Remember: The AC curve is the biggest indicator determining your economic loss. It is clear that the minimum point of the AC curve lies above the market price (see Figure 9).
- When you extend point \( e \) you will have to do it in both directions, because AC determines your cost.
- Income = the area OP\textsubscript{1}eQ\textsubscript{1} \hspace{1cm} Cost = the area OCBQ\textsubscript{1}
Your economic loss = the area P\textsubscript{1}CBe

![Figure 9](image)
5.4.7. Calculating the shutdown point and the break-even point

**Shutdown point:**
A firm should produce only if total revenue is equal to, or greater than, total variable cost.

**Break-even point**

Price

\[ P \]

\[ Q \]

\[ MC \]

\[ AC \]

\[ TVC \]

\[ MR \]

\[ AR \]

**Figure 10**

**Activity 1**

Study the diagram below and answer the questions that follow.

1. Define the concept market structure. (2)
2. How many sellers will one find in a monopoly market? (2)
3. In what market are all participants price-takers? Motivate your answer. (4)
4. Explain the shape of the individual demand curve under perfect competition. (4)
5. Under which market structure will you place the following businesses?
   - KFC
   - Eskom
   - Vodacom (6)
6. Explain in your own words the message behind the pie-charts shown above. (4)
Answers to activity 1

1. Market structure refers to how a market is organised. ✓ ✓ (2)
2. One ✓ ✓ (2)
3. Perfect markets ✓ ✓ there are too many producers and consumers for one producer to influence the price ✓ ✓ (4)
4. Horizontal to the quantity axis/perfectly elastic ✓ ✓ ✓ ✓ (4)
5. KFC: monopolistic competition ✓ ✓ Eskom: monopoly ✓ ✓ Vodacom: oligopoly ✓ ✓ (6)
6. Under perfect competition there are many sellers and buyers. ✓ ✓ Under monopolistic competition there are many sellers and a few buyers. ✓ ✓ In the oligopoly there are many buyers but few sellers. ✓ ✓ In a monopoly there is only one seller but many buyers. ✓ (4)
• **Production** – February 2012, question 1.1.6
• **Normal profit** – February 2012, question 1.3.5
• **Costs** – February 2012, question 3.1.2

**CHAPTER 5 essay practise (Question 8):**

*Essay writing is an important skill needed to succeed in Economics exams.* Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Explain with the aid of graphs how short- and long-term equilibrium for the individual producer is achieved under conditions of perfect competition. Use the following headings in your explanation: market supply and demand, normal profit, and economic profit and loss. (February/March 2011)
- Use graphs to analyse the various short-run equilibrium positions for an individual business in the perfect market. (November 2011)
- With the aid of the graphs below, examine the dynamics of long-term equilibrium in the individual firm and industry under conditions of perfect competition.

**THE INDUSTRY**

**THE FIRM**

- Discuss perfect competition as a market structure with special reference to the definition and characteristics. Conclude your discussion with reasons why you would not participate in the market under conditions of monopolistic competition. (November 2008)
Markets can fail for many reasons. The reasons for, and consequences of, market failure are explained in this chapter.

### 6.1 Key concepts
- 6.2.1 Externalities
- 6.2.2 Public goods
- 6.2.3 Merit and demerit goods
- 6.2.4 Imperfect competition
- 6.2.5 Lack of information
- 6.2.6 Immobile factors of production
- 6.2.7 Imperfect distribution of income and wealth

### 6.2 The reasons for market failure
- 6.2.1 Externalities
- 6.2.2 Public goods
- 6.2.3 Merit and demerit goods
- 6.2.4 Imperfect competition
- 6.2.5 Lack of information
- 6.2.6 Immobile factors of production
- 6.2.7 Imperfect distribution of income and wealth

### 6.3 The consequences of market failure
- 6.3.1 Externalities
- 6.3.2 Merit and demerit goods
- 6.3.3 Imperfect competition
- 6.3.4 Lack of information
- 6.3.5 Distribution of income and wealth

### 6.4 Cost benefit analysis
- 6.4.1 The mechanics of cost benefit analysis
- 6.4.2 How cost benefit analysis is used in practice
6.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost benefit analysis</td>
<td>A technique for enumerating (adding up) and evaluating the total social costs and total social benefits of an economic project</td>
</tr>
<tr>
<td>Externalities</td>
<td>Costs and benefits that convert private costs and benefits into social costs and benefits</td>
</tr>
<tr>
<td>Market failure</td>
<td>When free markets fail to produce the quantities of goods and services that people want at prices that reflect the marginal utility (value to the consumer) of the product</td>
</tr>
<tr>
<td>Public goods</td>
<td>Goods provided by the public sector (the state)</td>
</tr>
</tbody>
</table>

Use mobile notes to learn these concepts. See page xi in the introduction for instructions on making them.
6.2 The reasons for market failures

There are many reasons for market failure. These include:

6.2.1. Externalities

Externalities do not go through the price mechanism and have no price. Externalities are the difference between social costs and benefits, and private costs and benefits.

- **Private costs**: Internal costs incurred by consumers when they buy goods, e.g. tyres and clothes.
- **Private benefits**: Internal benefits accrued to those who produce goods and buy goods, e.g. producing a bicycle (for producer) and using the bicycle (consumer).
- **Social costs**: To those who create them and to society at large. For example, there are social costs of electricity due to capital, labour and inputs, and disposing of waste products like smoke and dirt. Private costs plus external costs = social costs.
- **Social benefits**: To those who create them and to society at large. For example, municipalities provide clean water to society. This results in fewer illnesses. Private benefits and external benefits = social benefits.

6.2.2. Public goods

Markets are incomplete and cannot meet the demand for all goods. Government provides public goods, which consist of:

- **Community goods**: e.g. police equipment
- **Collective goods**: e.g. streetlights

Features:
- **Non-rivalry**: Consumption by one person does not reduce consumption by another individual, e.g. a lighthouse
- **Non-excludability**: Consumption can’t be confined to those who pay for it (free riders can use them), e.g. radio and television.
- **Social benefits outstrip private benefits**: e.g. health care and education.
- **Non-rejectability**: Individuals are not able to abstain from consumption, e.g. street lighting.

6.2.3. Merit and demerit goods

- **Merit goods**: These are highly desirable for general welfare but not highly rated by the market, e.g. health care, education and safety.
- **Demerit goods**: These are over-consumed goods, e.g. cigarettes, alcohol and drugs. The government bans or reduces consumption of these products through taxation, and provides information to the population on their harmful effects.
6.2.4. Imperfect competition

- Competition in market economies is limited by the power of certain producers with mostly imperfect competition to prevent new businesses from entering the market.
- The modern market doesn’t allow for price negotiations.
- Advertising is used to promote producer sovereignty (dominance) which encourages consumers to buy existing products and allows producers to delay new products from entering the market until it is in their own interest (e.g. businesses have had the technology to produce long-life light bulbs for many years but have chosen not to launch them on the market).

6.2.5. Lack of information

- Consumers: To maximise their benefits, consumers need detailed information about goods and services. Advanced technology offers this to the consumer.
- Workers: Are often unaware of job opportunities.
- Entrepreneurs: Lack of information on costs, availability and productivity of factors of production impacts their effectiveness.

6.2.6. Immobility of factors of production

- Markets do not adjust rapidly due to lack of information and immobility of resources:
  - Labour: Takes time to move between occupations and geographical areas – supply adjusts slowly (skilled labour).
  - Physical capital: Factory buildings and infrastructure (e.g. telephone lines) move irregularly from one location to another.

6.2.7. Imperfect distribution of income and wealth

- Income distribution: The market system is neutral to issues of income distribution.
- Discrimination: Distorts earnings for women and minority groups, disabled persons and people subject to illness and incapacity.
6.3 The consequences of market failure

When markets fail, the government is forced to act in order to counteract these consequences. The five main consequences and government’s means of addressing them are given below:

6.3.1. Externalities
- **Tax the polluter:** Cost of production increases – supply curve shifts upward – reflects cost on producers.
- **Use regulations and legislation:** Force polluters to stop pollution (ban smoking in public).
- **Control pollution by granting permits:** Sell permits to polluters giving them the right to pollute within set limits. The government determines the acceptable amount of pollution.
- **Grant subsidies:** These lower the cost of production, causing supply to increase. Prices will decrease, and the quantity demanded and supplied will increase, e.g. education.

6.3.2. Merit and demerit goods
Use taxation, subsidies and legislation to control merit and demerit goods.
- **Merit goods:** Higher consumption of these goods is regarded as good for society. The government makes use of subsidies to encourage their use, e.g. subsidising the production and distribution of condoms.
- **Demerit goods:** The government uses taxes to discourage their consumption, e.g. cigarettes.

6.3.3. Imperfect competition
The government takes action when dominant firms behave abusively. Competition policy aims to stop restrictive practices.
- **State monopoly:** The state can increase competition in the market by granting licenses to private companies.
- **Natural monopoly:** The state can use legislation to force a monopoly to decrease the price of its product.

6.3.4. Lack of information
- Government provides information to consumers through legislation and the media.
- The Advertising Standards Authority of South Africa (ASA) is the government body that deals with misleading advertising.

6.3.5. Distribution of income and wealth
The government attempts to change the distribution of income and wealth by the following means:
- **The national budget and taxation:** Providing grants to the unemployed, to foster parents and to orphans or those looking after orphans; cutting taxes on low earners and increasing taxes on high earners and profitable businesses.
- **Subsidies:** Subsidising staple foods; implementing job creation programmes; providing meals to children in impoverished areas.
- **Regulatory measures:** Land reform; labour legislation; preferential access to government procurement contracts; black economic empowerment policies.
6.4 Cost benefit analysis (CBA)

Cost benefit analysis is applied to projects where one expects a significant difference between private and social costs and benefits, e.g. the Gautrain project. It brings objectivity to decision-making, identifies relevant benefits and costs of projects, and quantifies them in money terms in order to enable informed decision making.

6.4.1. The mechanics of cost benefit analysis

Cost benefit analysis involves six stages:

- To identify and quantify private costs (P)
- To identify and quantify external costs (E)
- To calculate social costs (S)
- To identify and quantify private benefits (P)
- To identify and quantify external benefits (E)
- To calculate social benefits (S)

6.4.2. How cost benefit analysis is used in practice

Cost benefit analysis is used:

- In the public sector when evaluating large-scale investment projects, e.g. road projects, airports.
- To identify and rank all possible costs and benefits according to their importance and remoteness from the main purpose of the project.

Activity 1

Study Figure 6.1 and answer the questions that follow.

Figure 6.1
1. What economic technique for enumerating and evaluating is depicted in the illustration? (2)

2. Give TWO recent examples of potential ‘operations’ in South Africa that will fit into the illustration. (2)

3. List ONE social benefit of each of the above projects. (4)

**Answers to activity 1**

1. Cost benefit analysis ✓ ✓ (2)
2. Gautrain ✓ Coega ✓ (2)
   Any other relevant fact.
   Coega: Job creation ✓ ✓ /increased standard of living ✓ ✓
   Any other relevant fact. (any 2) (4)

**Activity 2**

Distinguish between merit and demerit goods. [8]

**Answer to activity 2**

- Taxation, subsidies and legislation are used to control merit and demerit goods. ✓ ✓
- **Merit goods**: higher consumption of goods is regarded as good for society ✓ ✓ government makes use of subsidies ✓ ✓ (distribute condoms). ✓ ✓
- **Demerit goods**: government imposes taxes to discourage consumption ✓ ✓ (cigarettes). ✓ ✓

**Activity 3**

Discuss the features of collective goods. [8]

**Answer to activity 3**

- **Non-rivalry**: ✓ ✓ Consumption by one person does not reduce consumption by another individual ✓ ✓ e.g. a lighthouse ✓ ✓
- **Non-excludability**: ✓ ✓ Consumption can’t be confined to those who pay for it (free riders can use it) ✓ ✓ e.g. radio and television ✓ ✓
Activity 4

Discuss the distribution of wealth and income as a consequence of market failure. [8]

Answer to activity 4

• Through the national budget and taxation ✓✓
• Change the distribution of income by: ✓✓ Subsidies, transferring payments to poor households, providing goods and services free of charge, implementing job creation programmes ✓✓
• Regulatory measures: ✓✓ Land reform, labour legislation, preferential access to government procurement contracts, black economic empowerment policies ✓✓

Activity 5

Study the following illustration and answer the questions that follow:

1. Identify the negative externality depicted in the illustration. (2)
2. List TWO measures that can be applied by government to reduce this externality. (2)
3. What is the liability of the factory in this regard? (2)
4. What effect will this have on consumer prices? (2)

Answers to activity 5

1. Pollution ✓✓
2. Legal actions ✓✓ and subsidies ✓✓ (any 1)
3. To reduce the pollution ✓✓
4. Consumer prices will increase ✓✓
Exams

Below is a list of suggested past exam questions for extra practice:

- **Positive externalities** – February 2010, question 1.3.3
- **Resource allocation** – February 2010, question 3.1.2
- **Public and private goods** – February 2010, question 3.1.3
- **Negative externalities** – February 2010, question 3.3
- **Market failure** – February 2011, question 1.3.3
- **Community goods** – February 2011, question 3.1.3
- **Income redistribution** – February 2011, question 3.3
- **Merit and demerit goods** – November 2011, question 1.2.2
- **Government intervention** – November 2011, question 3.1.2
- **The demand curve** – November 2011, question 3.1.3
- **Products** – November 2011, question 3.1.4
- **Government policy** – November 2011, question 3.2
- **Price fixing** – November 2011, question 3.4
- **Cost-benefit analysis** – November 2011, question 3.5
- **Merit goods** – February 2012, question 1.1.5
- **Market failure** – February 2012, question 3.5
- **Price discrimination** – February 2012, question 6.1.3
- **Cost-benefit analysis** – February 2012, question 6.1.4
- **Externalities** – February 2012, question 6.4

CHAPTER 6 essay practise (Question 7):

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Discuss FIVE reasons for market failures and briefly describe the South African government’s attempts to improve income distribution. (February/March 2010)
There are a number of different types of imperfect markets, e.g., monopolies, oligopolies, and monopolistic competition. An imperfect market is characterised by imperfect competition. Some participants have earlier or exclusive access to information that benefits them in the marketplace at the expense of their competitors. Certain participants will be able to access the market easier than other participants, i.e. the supply of and demand for products will not be equal, and the matching of buyers to sellers will not be immediate.
### 7.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Artificial monopoly</td>
<td>The barriers to entry are not economic in nature, but caused by other factors. For example, a patent – this is the legal right of a holder to exclusively manufacture a product</td>
</tr>
<tr>
<td>Average cost (AC)</td>
<td><strong>Average cost</strong> = Total cost divided by the quantity of goods produced</td>
</tr>
<tr>
<td>Average revenue (AR)</td>
<td><strong>Average revenue</strong> = Total revenue divided by the quantity of goods sold</td>
</tr>
<tr>
<td>Cartel</td>
<td>An organisation of businesses in an oligopoly that comes into existence with the aim of operating like a monopoly</td>
</tr>
<tr>
<td>Collusion</td>
<td>An arrangement between businesses with the aim of limiting competition between them</td>
</tr>
<tr>
<td>Demand curve</td>
<td>The <strong>demand curve</strong> is the graph that shows the relationship between the price of a product and the amount of the product consumers are prepared to purchase at that price. The demand curve for all consumers is derived from the demand curve of every individual consumer – the individual demands at each price are added together.</td>
</tr>
<tr>
<td>Imperfect market</td>
<td>When the market price is not a pure reflection of the scarcity (lack) of that product</td>
</tr>
<tr>
<td>Long-term equilibrium</td>
<td>Under perfect competition, the market price, the number of firms in the industry, and the scale of production of each firm will adjust so that each firm produces at the lowest point on its long-run average cost curve (its minimum efficient scale).</td>
</tr>
<tr>
<td>Marginal cost (MC)</td>
<td><strong>Marginal cost</strong> is the change in total cost that arises from the additional cost of producing one more unit of a good.</td>
</tr>
<tr>
<td>Marginal revenue (MR)</td>
<td><strong>Marginal revenue</strong> (MR) is the additional revenue generated by increasing product sales by one unit, i.e. the revenue the last item sold generated for the firm</td>
</tr>
<tr>
<td>Monopoly</td>
<td>A market structure where only one seller (producer) operates. Entry is blocked and the product has no close substitutes</td>
</tr>
<tr>
<td>Monopolistic competition</td>
<td>A market structure with many buyers and sellers where entry is relatively easy but the product is differentiated, e.g. toothpaste</td>
</tr>
<tr>
<td>Natural monopoly</td>
<td>A single business in an industry which serve the whole market at a lower price than two or more businesses together</td>
</tr>
<tr>
<td>Non-homogenous</td>
<td>Manufacture different varieties of their products in order to make it difficult for other companies to copy that specific product</td>
</tr>
<tr>
<td>Oligopoly</td>
<td>A market structure where only a few sellers operate. Entry is difficult and products can be differentiated or standardised</td>
</tr>
<tr>
<td>Price leadership</td>
<td>A situation where one firm fixes a price and the others accept it as the market price</td>
</tr>
<tr>
<td>Total cost (TC)</td>
<td><strong>Total cost</strong> (TC) describes the total economic cost of production. It includes fixed costs (e.g. machinery) and variable costs (e.g. raw materials).</td>
</tr>
<tr>
<td>Total revenue (TR)</td>
<td><strong>Total revenue</strong> = price × quantity, i.e. the selling price of the product times the quantity sold</td>
</tr>
</tbody>
</table>
7.2 Market structures

There are FOUR different market structures: perfect competition, monopoly, oligopoly and monopolistic competition.

Perfect markets differ from imperfect markets in the following ways:

- **Price:** Usually the price on the perfect market is lower than on the other markets due to competition. Imperfect markets, e.g. monopolies, are price-makers and need not lower their prices over the long term, as there are no competitors.

- **Cost:** In the perfect market, producers try to produce at the lowest cost level. This is not the case in the imperfect market.

- **Economic profit:** In the perfect market, due to mass production (low unit cost), more competitors enter the market with better technology, and the market only experiences a normal profit over the long run. In imperfect markets the economic profit remains.

- **Quantities:** These are usually less in imperfect markets, compared to the perfect market where the producers tend to move towards mass production over the long run.

A comparison of the different market structures:

<table>
<thead>
<tr>
<th></th>
<th>Perfect competition</th>
<th>Monopolistic competition</th>
<th>Oligopoly</th>
<th>Monopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Examples</strong></td>
<td>International commodity markets, e.g. gold</td>
<td>Fast-food outlets</td>
<td>Petrol and oil markets</td>
<td>Eskom</td>
</tr>
<tr>
<td><strong>Number of businesses</strong></td>
<td>Enough that a single business cannot influence the market price</td>
<td>A very large number</td>
<td>So few that each business must take the actions of the others into account</td>
<td>One business</td>
</tr>
<tr>
<td><strong>Nature of product</strong></td>
<td>Homogenous (same kind)</td>
<td>Differentiated, e.g. cool drinks</td>
<td>Homogenous or differentiated</td>
<td>Unique product without any close substitutes</td>
</tr>
<tr>
<td><strong>Market entry</strong></td>
<td>Completely free</td>
<td>Free</td>
<td>From free to restricted</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Control over price</strong></td>
<td>None</td>
<td>Few</td>
<td>Considerable, but less than with a monopoly</td>
<td>Considerable</td>
</tr>
<tr>
<td><strong>Information</strong></td>
<td>Complete</td>
<td>Incomplete</td>
<td>Incomplete</td>
<td>Complete</td>
</tr>
<tr>
<td><strong>Demand curve</strong></td>
<td>Market demand curve slopes from left to right – individual demand curve is horizontal</td>
<td>Downward sloping</td>
<td>Downward sloping</td>
<td>Downward sloping and equals the market demand curve</td>
</tr>
<tr>
<td><strong>Long term economic profit</strong></td>
<td>Normal profit</td>
<td>Normal profit</td>
<td>Positive</td>
<td>Positive</td>
</tr>
<tr>
<td><strong>Seller market power</strong></td>
<td>None (price-taker)</td>
<td>Some</td>
<td>A whole lot</td>
<td>Many (price-maker)</td>
</tr>
<tr>
<td><strong>Technical efficiency</strong></td>
<td>Yes</td>
<td>Close</td>
<td>Possible</td>
<td>Possible</td>
</tr>
<tr>
<td><strong>Allocative efficiency</strong></td>
<td>Yes</td>
<td>Close</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Table 7.1: A comparison of different market structures
7.3 Monopolies

Monopolies are market structures where one seller owns the market. The product has no close substitutes and entry to the market for any competitors is blocked. The seller can control the market price.

7.3.1. Characteristics

- **Monopolies are confronted with the demand curve:** The demand curve of the individual producer is that of the market as a whole, which slopes downwards from left to right.
- **Monopolies decide on their production levels:** The quantity sold is determined by market demand and entry to the market is blocked.
- **Monopolies are exposed to market forces:** The producer cannot ask excessive prices as consumers have limited budgets.
- **Monopolies do not face substitutes:** There are few products with no close substitutes, e.g. DStv decoders.
- **Monopolies may enjoy favourable circumstances:** In a certain geographic area, they may be the only supplier, e.g. of milk.
- **Monopolies may exploit consumers:** The government takes steps to monitor monopolies.
- **Monopolies are protected by barriers of entry:**
  - **Natural monopolies:** Occur where development costs, e.g. electricity, are so high that a single business serves the community.
  - **Artificial monopolies:** Occur where barriers keep opponents from entering the market, e.g. patents (Kreepy Krauly).
### 7.3.2. Revenue

- **The demand curve** for a monopolist is the market demand curve and slopes downwards from left to right (DD/AR). See the top graph in Figure 1.
- Any point on the curve is an indication of the **quantity** of the product to be sold and the **price** at which trade takes place.
- Any price-quantity combination on the demand curve is also its average revenue (AR) curve.
- The average revenue from each product is calculated by dividing the total revenue by the quantity = the price. See the bottom graph in Figure 1 (left).
- The **marginal revenue** (MR) curve runs below the demand curve (AR) – it always intersects the horizontal axis at a point halfway between the origin and the point of intersection of the demand curve (AR).
- The monopolist will try to **fix the price above the centre of the demand curve**, because only then will his total revenue increase. See Figure 1. Note how at Q₁ total revenue is at its highest. Q₁ intersects the demand curve of the top graph above the centre of the curve.

### 7.3.3. Profit in the short term

#### Step 1: Draw your two axes

First, draw your TWO axes:
Price (vertical) and Quantity (horizontal) – remember, they meet at the origin (0). Everything counts for marks – do not leave out anything. Now go to step 2.

#### Step 2:
The two revenue curves start on the price axis and move down to meet the **quantity axis**. Draw these axes now. Then go to step 3.
Step 3:
This MC curve intersects the AC curve at the minimum point of the AC curve.

Figure 4

Step 4:
The most important point on the graph is where MC = MR (look for the dot ●). At this point: equilibrium/maximum profit/profit maximisation is reached (all the same point).

Step 5:
This dot is extended upwards and downwards. Your cost occurs where it meets the AC curve, and your market price occurs where it meets the AR curve (demand curve). Remember, a monopoly company will determine the price.

Figure 5
The graph below shows the economic profit made by a monopoly:

![Graph showing economic profit](image)

**Figure 6: The economic profit made by a monopoly**

- The cost structure of the monopoly is the same as that of competitive businesses.
- Determine the point where MC = MR, the point where the production cost of the last unit is equal to the revenue it earns (point e) – profit-maximising production quantity of Q₁ on the horizontal axis.
- To determine the price at which Q₁ is sold, move vertically upwards from e to L on the demand curve. The market price is therefore determined at P.
- Total revenue is greater than the short-term total costs. The monopolist makes a profit (due to demand and cost of production).

### 7.3.4. Loss in the short term

When you draw the economic loss, the graph stays the same, EXCEPT the AC curve moves to the right - up, and totally misses the AR (demand) curve (see Figure 7).

**Remember:** To draw the economic loss, you find the market price (OP) where the dotted line meets AR. Then extend the line further to meet the AC curve – THAT indicates your cost (OC).

The total income = Price (OP) × Quantity (OQ) = the area OPNQ

The total cost = Cost (OC) × Quantity (OQ) = the area OCLQ.

Economic loss = income – cost

![Graph showing economic loss](image)

**Figure 7: The economic loss of the monopoly**
Learn the following THREE bullets as a description for the economic loss of a monopoly:

- The monopoly suffers short-term losses when the AC curve lies above the demand curve (DD).
- Equilibrium is reached where MR = MC (a loss-minimising situation).
- The monopoly will produce a quantity Q1 and sell at price P1. The total costs are the area OCLQ; the total revenue is the area OPNQ. The loss will be that part that is shaded (the area PCLN).

### 7.3.5. Long-term equilibrium

The long-term equilibrium graph is illustrated in Figure 8.

- The two legs open up to the right ...
- The MC curve lies down ...
- The AC opens up ...

**Let us draw ...!**

![Figure 8: Long term equilibrium](image_url)
7.4 Oligopolies

In oligopolies, a few sellers dominate the market. When there are only 2 sellers we call it a duopoly.

7.4.1. Characteristics of oligopolies
For a description of the characteristics of oligopolies, refer to Table 7.1 on market structures on page 70.

7.4.2. Non-price competition
• Oligopolists compete on the basis of product differentiation and efficient service, underscored by advertising, as opposed to competing on price.
  For example, in South Africa, a motor group launches a sales campaign with a special discount – rivals introduce the same offer.

7.4.3. Collusion
• Producers do not normally know much about the policies and behaviour of their competitors. It is an uncertain environment.
• Oligopoly producers reduce uncertainty by colluding with other producers. They agree on the prices they are going to demand and the quantities produced.
• This has advantages for these producers because they can charge higher prices and make a higher profit. There is less uncertainty about profit margins, and it is difficult for other competitors to enter the market.
• There are 2 forms of collusion:
  – Cartel: Collusion is open and formal. This type of formal collusion is forbidden by law.
  – Price leadership: Firms find a way to reduce uncertainties in the market. One business fixes the price and others act as price followers.
7.5 Monopolistic competition

Monopolistic competition is a market structure with many buyers and sellers where entry is easy, but the product is differentiated by elements such as packaging and branding, e.g. toothpaste.

7.5.1. Characteristics

The general characteristics of monopolistic competition are:

- **Differentiated products**
  - The products are not identical.
  - The product differences may be imaginary.
  - The product differences may just be in packaging.

- **A hybrid structure**
  - This is a combination of perfect competition and monopoly.
  - There are many small sellers with differentiated products.
  - Producers can freely enter or leave the market over the long term.

- **Often it is local**
  - It most commonly occurs in the retail and services sector, e.g. filling stations.

- **Diverse businesses**
  - One cannot derive the demand and supply curve as for industry in perfect competition.
  - A single equilibrium price cannot be determined.

7.5.2. Non-price competition

- Demand for specific products is increased to make competition less price elastic through marketing campaigns and product variation, e.g. sugar content is reduced in a breakfast cereal to appeal to dieters.
- Imaginary differentiation is encouraged, e.g. the value of a brand is promoted.
- Product differentiation is highlighted.
- Brands play significant roles.

7.5.3. Prices and production levels in the short- and long-term

- The product differs – the producer has monopolistic power – and the demand curve slopes downward like the monopolist’s demand curve.
- The producer does not make huge profits because there is competition.
- Short-term equilibrium corresponds with monopoly, but the demand curve is more price elastic due to good substitutes.
### Activity 1

Complete the following table by filling in the missing information:

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Perfect market</th>
<th>Monopolistic competition</th>
<th>Oligopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>So many competitors that a single business cannot influence the market price</td>
<td>A very large number</td>
<td>So few competitors that each business takes the actions of the others into account</td>
</tr>
<tr>
<td>Market entry</td>
<td>Completely free</td>
<td>Free</td>
<td>Downward sloping</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term economic profit</td>
<td></td>
<td>Positive</td>
<td></td>
</tr>
<tr>
<td>Seller market power</td>
<td></td>
<td>Some control</td>
<td>Considerably more than oligopoly</td>
</tr>
<tr>
<td>Control over price</td>
<td></td>
<td>Fast-food outlets</td>
<td></td>
</tr>
<tr>
<td>Examples</td>
<td></td>
<td>Ekom</td>
<td></td>
</tr>
</tbody>
</table>

### Answer to activity 1

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Perfect market</th>
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<th>Oligopoly</th>
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<td>Free</td>
<td>Free to restricted</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Blocked</td>
</tr>
<tr>
<td>Demand curve</td>
<td>Slopes from left to right</td>
<td>Downward sloping</td>
<td>Downward sloping = market demand</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term economic profit</td>
<td>Normal profit</td>
<td>Normal profit</td>
<td>Positive</td>
</tr>
<tr>
<td>Seller market power</td>
<td>None, price-taker</td>
<td>Some</td>
<td>Many (price-maker)</td>
</tr>
<tr>
<td>Control over price</td>
<td>None</td>
<td>Few</td>
<td>Considerable</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Considerably more than oligopoly</td>
</tr>
<tr>
<td>Examples</td>
<td>Gold and oil</td>
<td>Fast-food outlets</td>
<td>Petrol and oil</td>
</tr>
</tbody>
</table>
Activity 2

Study the following graph and answer the questions that follow:

1. Define the term imperfect market. (2)
2. Motivate why the above graph indicates short term equilibrium. (4)
3. Which point on the graph indicates profit maximisation? (2)
4. Calculate the economic profit. (6)

Answers to activity 2

1. An imperfect market occurs where the market price is not a pure reflection of the scarcity of that product. ✓ ✓ (2)
2. The marginal cost curve and average cost curves indicate SMC/SAC. ✓ ✓ ✓ ✓ (4)
   The slope of the curves indicates a short run. ✓ ✓ 
3. d where MR = MC ✓ ✓ (2)
4. Income = Price (15) × Quantity (100) ✓ 
   = R1 500 ✓ 
Cost = Cost (10) × Quantity (100) ✓ 
   = R1 000 ✓ 
Economic profit = Income (R1 500) – Cost (R1 000) 
   = R500 ✓ ✓ (6)

[14]
Below is a list of suggested past exam questions for extra practice:

- **Duopoly (2 marks)** – February 2010, question 1.1.5
- **Price leadership (2 marks)** – February 2010, question 1.1.6
- **Collusion (2 marks)** – February 2010, question 1.2.2
- **Monopolistic competition (2 marks)** – February 2010, question 3.1.4
- **Characteristics of monopoly (6 marks)** – February 2010, question 3.2
- **Oligopoly and perfect competition (16 marks)** – February 2010, question 3.4
- **Oligopoly (2 marks)** – February 2011, question 3.1.1
- **Monopolistic competition (2 marks)** – February 2011, question 3.1.2
- **Characteristics of oligopoly (8 marks)** – February 2011, question 3.6
- **Monopoly as market structure (50 marks)** – February 2011, question 8
- **Oligopoly (2 marks)** – November 2010, question 1.1.4
- **Cartel (2 marks)** – November 2010, question 1.1.6
- **Collusion (2 marks)** – November 2010, question 3.1.1
- **Types of monopoly** – November 2010, question 3.1.2
- **Monopoly (2 marks)** – November 2010, question 3.1.4
- **Characteristics of monopolistic competition – oligopoly (6 marks)** – November 2010, question 3.2
- **Non-price competition – oligopoly (6 marks)** – November 2010, question 3.5
- **Graph monopoly – economic profit (8 marks)** – November 2010, question 3.6
- **Natural monopoly (2 marks)** – November 2011, question 1.1.5
- **Demand curve monopoly (2 marks)** – November 2011, question 3.1.3
- **Graph – monopoly (10 marks)** – November 2011, question 3.3
- **Cartel – market structure (10 marks)** – November 2011, question 3.4

**CHAPTER 7 essay practise (Question 8):**

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Discuss monopoly as a market structure. In your discussion compare this market with conditions of perfect competition. (February/March 2011)
- Discuss monopoly as a market structure and illustrate, with the aid of a graph, how a monopolist can achieve economic profit. (February/March 2012)
- Examine the monopoly as a market structure and briefly compare it to the perfect market. (February/March 2009)
Economic growth and development are key aims of economic policy. Economic growth focuses on the economy with the understanding that, as the economy grows, so all the citizens of the country will prosper. Economic development focuses on implementing policies that will help improve each citizen’s standard of living and economic opportunities.
## 8.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accelerated and Shared Growth Initiative for South Africa (AsgiSA)</td>
<td>An initiative to promote development strategies, e.g. infrastructure and skills development</td>
</tr>
<tr>
<td>Broad Based Black Economic Empowerment (BBBEE)</td>
<td>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</td>
</tr>
<tr>
<td>Black Economic Empowerment (BEE)</td>
<td>An earlier policy similar to BBBEE, with the aims of distributing wealth to and developing skills in black citizens in post-apartheid South Africa</td>
</tr>
<tr>
<td>Development Bank of Southern Africa (DBSA)</td>
<td>Promotes development in the southern African region by financing important development projects</td>
</tr>
<tr>
<td>Demand-side approach</td>
<td>Monetary and fiscal policies that attempt to change the level of aggregate demand</td>
</tr>
<tr>
<td>Economic development policy</td>
<td>A policy that involves the interaction of economic, social and human development</td>
</tr>
<tr>
<td>Economic development policy</td>
<td>A policy that involves the interaction of economic, social and human development</td>
</tr>
<tr>
<td>Economic growth policy</td>
<td>A policy that helps to increase the annual total production or income in the economy</td>
</tr>
<tr>
<td>Economic growth</td>
<td>An increase in the productive capacity of an economy over time. It is a change in the real GDP</td>
</tr>
<tr>
<td>Economic growth policy</td>
<td>A policy that helps to increase the annual total production or income in the economy</td>
</tr>
<tr>
<td>Growth, Employment and Redistribution (GEAR)</td>
<td>A strategy to promote economic growth, increase employment and redistribute income</td>
</tr>
<tr>
<td>Globalisation</td>
<td>The worldwide interaction of economies with trade as an important element</td>
</tr>
<tr>
<td>Integrated Manufacturing Strategy (IMS)</td>
<td>A strategy to strengthen institutional capacity to deliver services that will facilitate development</td>
</tr>
<tr>
<td>Joint Initiative on Priority Skills Acquisition (JIPSA)</td>
<td>An initiative to facilitate job creation</td>
</tr>
<tr>
<td>Life expectancy</td>
<td>Expresses in number of years how long a child born today is expected to live</td>
</tr>
<tr>
<td>National Growth Path (NGP)</td>
<td>Initiatives to stimulate economic growth</td>
</tr>
<tr>
<td>North/South divide</td>
<td>Refers to the developed countries in the Northern hemisphere and the developing countries in the Southern hemisphere</td>
</tr>
<tr>
<td>Public and Private Sector Partnerships (PPP)</td>
<td>These are contracts between a public sector institution/municipality and a private business, in which the design, financing, building and operation of public sector projects is managed by the private business</td>
</tr>
<tr>
<td>Reconstruction and Development Programme (RDP)</td>
<td>A development policy to improve service delivery to the poor and create an environment for human development</td>
</tr>
<tr>
<td>South African Reserve Bank (SARB)</td>
<td>Central bank of South Africa with the main goal to maintain price stability, thereby promoting balanced and sustainable growth</td>
</tr>
<tr>
<td>Small, Medium and Micro Enterprises (SMMEs)</td>
<td>A small business that has a small share of the market place; operates independent of larger enterprises; employs few people; and is managed directly by owners</td>
</tr>
<tr>
<td>Supply-side approach</td>
<td>Policies aimed at increasing the aggregate supply</td>
</tr>
</tbody>
</table>
8.2 The objectives of economic development

Economic development aims to:
- **Increase the availability and distribution of basic sustenance** (food, clothing and shelter for minimum standards of living);
- **Produce higher living standards** (more income, employment, education, cultural and human values, self-respect and self-esteem); and
- **Increase the range of economic and social options** and remove restricting factors (dependence, ignorance and poverty).

8.3 The difference between growth and development

<table>
<thead>
<tr>
<th>Economic growth</th>
<th>Economic development</th>
</tr>
</thead>
<tbody>
<tr>
<td>A process by which the productive capacity of the economy increases over time</td>
<td>A process that concentrates on peoples’ standard of living, self-respect and freedom of choice</td>
</tr>
<tr>
<td>Leads to rising levels of national output and income</td>
<td>Growth should lead to development</td>
</tr>
<tr>
<td>Is an increase in real gross domestic product (GDP)</td>
<td>The ultimate aim of economic policy is an improved standard of living of the population per capita by means of economic growth and development</td>
</tr>
</tbody>
</table>

8.4 Growth and development policies

At certain periods, the South African government has focused its initiatives on economic growth, while at other points, policy emphasis has shifted to economic development (see Graph 1 below).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MS</td>
<td>RDP</td>
<td>GEAR</td>
<td>BEE</td>
<td>ASGI</td>
<td>JIPSA</td>
<td>NGP</td>
</tr>
</tbody>
</table>

Graph 1

Initiatives focusing on **growth** include:
1. Growth Employment and Redistribution (GEAR)
2. Integrated Manufacturing Strategy (IMS)
3. Accelerated and Shared Growth Initiative for South Africa (AsgiSA)
4. National Growth Path (NGP)

Initiatives focusing on **development** include:
1. Reconstruction and Development Programme (RDP)
2. Black Economic Empowerment (BEE)
3. Joint Initiative on Priority Skills Acquisition (JIPSA)
Table 8.1 presents a comparison of growth and development policies:

<table>
<thead>
<tr>
<th>Growth</th>
<th>Development</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macroeconomic policies</strong></td>
<td><strong>Development policies</strong></td>
</tr>
<tr>
<td>These include measures aimed at:</td>
<td>These include measures aimed at achieving industrial, agricultural and human development:</td>
</tr>
<tr>
<td>1. Higher economic growth</td>
<td>1. <strong>Microeconomic initiatives</strong></td>
</tr>
<tr>
<td>2. High levels of employment</td>
<td>• Facilitating increased competition, opening up resource markets, enabling land-use and environmental policy.</td>
</tr>
<tr>
<td>3. Price stability</td>
<td>2. <strong>Social care</strong></td>
</tr>
<tr>
<td>4. Exchange rate stability</td>
<td>• Social welfare and security and poverty alleviation</td>
</tr>
<tr>
<td>5. Economic equity</td>
<td>• Policies to redress past inequalities, including Employment Equity and BEE/BBBEE</td>
</tr>
<tr>
<td>These contribute to economic growth through <strong>taxation</strong> to provide more social goods and services, e.g. infrastructure, housing and health care to improve the standard of living.</td>
<td>3. <strong>Macroeconomic characteristics and desired outcomes:</strong></td>
</tr>
<tr>
<td></td>
<td>• Affirmative action</td>
</tr>
<tr>
<td></td>
<td>• Land redistribution and restitution</td>
</tr>
</tbody>
</table>

All the above measures should be evaluated in terms of international benchmarks.

The instruments that are used to carry the policies into reality are demand-side and supply-side approaches.
8.5 Demand-side and supply-side approaches

8.5.1. Demand-side approach

A demand-side approach involves discretionary changes in monetary and fiscal policies with the aim of changing the level of aggregate demand.

Monetary policy is driven by the South African Reserve Bank (SARB). It aims to stabilise prices by managing inflation.

In South Africa, the following instruments are used to support monetary policy:
- **Interest rate changes**: Influence credit
- **Open market transactions**: Buy and sell government equities
- **Moral persuasion**: SARB consults with banks
- **Cash reserve requirement**: The prescribed (official set) percentage of deposits which remains in banks.

Fiscal policy is driven by the state in the following way:
- **Through the budget process**: To stimulate macro-economic growth
- **Through progressive personal income tax**: Higher income earners are taxed at higher rates
- **Through wealth taxes**: For example, properties are taxed annually (Capital Gains Tax)
- **Through cash benefits**: Social benefits are increased to the needy, e.g. old-age pensioners

8.5.2. Supply-side approach

A supply-side approach includes anything that can influence the aggregate supply of goods and services, with the focus on microeconomic components, e.g. competition and potential output.

Government intervention aims to facilitate the smooth operation of markets in order to stimulate growth and development.

The South African approach aims at improving the effectiveness and efficiency of markets. This requires:
- **Markets to operate more equitably and inclusively**: More blacks must be accommodated in the mainstream economy if it is to work efficiently.
- **Business efficiency**: Taxes must be collected efficiently, capital formation must increase, human resources must be supported to improve, and free advisory services must be made available so that business efficiency improves.
- **The cost of doing business must be lowered**: Transport, communication and energy costs must decrease.

Measures are:
- **Employment Equity Act**: Prohibits (makes illegal) unfair discrimination and requires that the workforce reflects the racial and gender profile of the population in an equity plan filed by business with the Department of Labour.
- **Broad-Based Black Economic Empowerment Act (BBBEE)**: Numbers of black people that own, manage and control the country’s economy must increase significantly and income inequalities must decrease substantially.
• **Efficiency of markets**: Includes productive and **allocative efficiency**. The allocation of resources is regarded as efficient when it is impossible to reallocate the resources to make at least one person better off without making someone else worse off. **Productive efficiency** occurs when all the businesses in an industry produce so that their long-run average or unit costs (AC) are at a minimum. Resources are economised so there is no waste. The allocation of resources is regarded as efficient when it is impossible to reallocate the resources to make at least one person better off without making someone else worse off. Productive efficiency occurs when all the businesses in an industry produce so that their long-run average or unit costs (AC) are at a minimum. Resources are economised so there is no waste.

• **Competition is increased by**:
  - Establishing new businesses
  - Attracting Foreign Direct Investment (FDI)
  - Reducing import restrictions
  - Ensuring open competition through the enforcement of the Competitions Act

• **Promoting Small, Medium and Micro Enterprises (SMMEs)**:
  - Department of Trade and Industry (DTI), Industrial Development Corporation (IDC) and the National Small Business Act
  - Deregulation – Laws are revised to help change power imbalances

• **Privatisation** – Some government businesses, e.g. forestry, are sold to the private sector. Some are partially sold (Telkom) and some are considered for Public Private Partnership (PPP), e.g. Denel. Others must face competition, e.g. the SABC.
8.6 The North-South divide

Table 8.2 shows different ways to distinguish between developed countries (in the North) and developing countries (in the South).

<table>
<thead>
<tr>
<th>Standard of living:</th>
<th>NORTH (developed)</th>
<th>SOUTH (developing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Real GDP per capita</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>• Life expectancy</td>
<td>75 years</td>
<td>48 years</td>
</tr>
<tr>
<td>• Education: Literacy level</td>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Globalisation inequalities:</th>
<th>NORTH (developed)</th>
<th>SOUTH (developing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Poverty level</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>• Economic growth</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>• Production and trade</td>
<td>Manufacturing goods</td>
<td>Receive subsidies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Environment:</th>
<th>NORTH (developed)</th>
<th>SOUTH (developing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Mass production and</td>
<td>Mainly responsible for damaging</td>
<td>Affect developing countries more negatively</td>
</tr>
<tr>
<td>consumption damages the ozone layer, caused by pollution and toxic waste</td>
<td>the ozone layer</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sustainable development:</th>
<th>NORTH (developed)</th>
<th>SOUTH (developing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The pattern of development that permits future generations to live as well as the current generation</td>
<td>Practices used in production are more in favour of sustainable development</td>
<td>Production practices do not promote sustainable development</td>
</tr>
</tbody>
</table>

Table 8.2: The North-South divide

Activity 1

Study the cartoon below and answer the questions that follow:

1. What is the message behind the cartoon? (2)
2. List any TWO countries involved in this phenomena. (2)
3. List any TWO products displayed in the cartoon. (4)

[8]
Answers to activity 1

1. Globalisation ✓✓
2. USA ✓ and Japan ✓
3. Motor vehicles ✓✓ and fuel ✓✓

[8]

Activity 2

Study the cartoon below and answer the questions that follow:

1. What is the message behind the cartoon? (2)
2. What is the main objective of Broad-Based Black Economic Empowerment? (2)

Answers to activity 2

1. The people are dissatisfied about the way the government is handling Black Economic Empowerment (corruption and nepotism). ✓✓
2. To advantage the previously disadvantaged section of the population ✓✓
Activity 3

Distinguish between economic growth and economic development.

Answer to activity 3

<table>
<thead>
<tr>
<th>Economic growth</th>
<th>Economic development</th>
</tr>
</thead>
<tbody>
<tr>
<td>• A process by which the productive capacity of the economy increases over time. ✔ ✔</td>
<td>• A process that concentrates on peoples’ standard of living, self-respect and freedom of choice. ✔ ✔</td>
</tr>
<tr>
<td>• Leads to rising levels of national output and income. ✔ ✔</td>
<td>• Growth should lead to development ✔ ✔</td>
</tr>
<tr>
<td>• Is an increase in real gross domestic product (GDP). ✔ ✔</td>
<td>• The ultimate aim of economic policy is an improved standard of living of the population per capita by means of economic growth and development. ✔ ✔</td>
</tr>
</tbody>
</table>

(any 3) [8]

Activity 4

Explain unequal standards of living as a characteristic of the North/South divide.

Answer to activity 4

• The real per capita income in developing countries are low compared to developed countries, ✔ e.g. 87% of the world’s total income is produced by 15% of the world’s population ✔
• Life expectancy in developing countries are as low ✔ as 47 years compared to a life expectancy of over 80 years in a country like Sweden ✔
• Low levels of education ✔ the adult literacy rate determines the effectiveness of education ✔
Below is a list of suggested past exam questions for extra practice:

- **Economic development (2 marks)** – February 2010, question 1.1.7
- **Physical infrastructure (2 marks)** – February 2010, question 4.1.1
- **CSIR (2 marks)** – February 2010, question 4.1.2
- **North/South Divide (6 marks)** – February 2010, question 6.2
- **BEE (data base 10 marks)** – February 2010, question 6.3
- **Economic growth (2 marks)** – February 2011, question 1.1.7
- **Economic growth (2 marks)** – February 2011, question 4.1.1
- **BEE (2 marks)** – February 2011, question 4.1.2
- **Economic growth policy (8 marks)** – February 2011, question 4.5
- **North/South divide (8 marks)** – February 2011, question 4.6
- **Economic development (2 marks)** – November 2010, question 1.1.9
- **BEE (2 marks)** – November 2010, question 1.2.4
- **GEAR (2 marks)** – November 2010, question 4.1.3
- **North/South divide (10 marks)** – November 2010, question 4.4
- **Economic growth and development (8 marks)** – November 2010, question 4.6
- **Factors determining economic growth (8 marks)** – November 2010, question 6.6
- **Gini coefficient (2 marks)** – November 2011, question 1.3.6
- **Deregulation (2 marks)** – November 2011, question 4.1.1
- **BEE (2 marks)** – November 2011, question 4.1.4
- **North/South (10 marks)** – November 2011, question 4.4
- **Demand-side approach (8 marks)** – November 2011, question 4.5

**CHAPTER 8 essay practise (Question 9):**

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Compare and evaluate South Africa’s growth and development policies in terms of international benchmarks, and highlight the North–South divide. (Feb/March 2011)
Industrial development is the development approach adopted by South Africa.
## 9.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

Use mobile notes to help you learn these key concepts. Find out more about mobile notes on page xi in the introduction.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black Business Supplier Development Programme (BBSdP)</td>
<td>An incentive for black businesses consisting of an 80% cash grant to help increase the number of cash suppliers</td>
</tr>
<tr>
<td>Critical Infrastructure Programme (CIP)</td>
<td>Offers cash grants for projects that require new, expanded or improved infrastructure</td>
</tr>
<tr>
<td>Department of Trade and Industry (DTI)</td>
<td>Provides a competitive, socially responsible environment for investment, trade and enterprise development. It helps broaden participation in the economy to strengthen economic development; and it promotes structural transformation of the economy.</td>
</tr>
<tr>
<td>Foreign Investment Grant (FiG)</td>
<td>Offers cash grants for foreign investors who invest in new manufacturing businesses in South Africa</td>
</tr>
<tr>
<td>General Agreement on Tariffs and Trade (GATT)</td>
<td>A multilateral agreement regulating international trade. Its purpose is to reduce tariffs and other trade barriers.</td>
</tr>
<tr>
<td>Industrial Development Corporation (IDC)</td>
<td>Set up by government to promote economic growth and industrial development in South Africa and Africa. It promotes entrepreneurship by building competitive industries and enterprises based on sound business principles.</td>
</tr>
<tr>
<td>Industrial Development Zone (IDZ)</td>
<td>These are purpose-built industrial estates that are physically enclosed and linked to an international port or airport e.g. Coega. Businesses are encouraged to open in IDZs by being offered improved tax rates or incentives.</td>
</tr>
<tr>
<td>Integrated Manufacturing Strategy (IMS)</td>
<td>A strategy to strengthen institutional capacity to deliver services that will facilitate development</td>
</tr>
<tr>
<td>Industrial development</td>
<td>Refers to policies that are aimed at the encouragement of industrial investment and greater industrial efficiency</td>
</tr>
<tr>
<td>Regional industrial development</td>
<td>Refers to policies that are aimed at increasing the economic livelihood of specific areas or geographical regions</td>
</tr>
<tr>
<td>Southern African Development Community (SADC)</td>
<td>An inter-governmental organisation whose goal is to further socio-economic cooperation and integration, as well as political and security cooperation among 15 southern African states</td>
</tr>
<tr>
<td>Spatial Development Initiatives (SDI)</td>
<td>Initiated to attract infrastructure and business investments to neglected and underdeveloped areas, e.g. Maputo Corridor</td>
</tr>
<tr>
<td>Small and Medium Enterprise Development Programme (SMEDP)</td>
<td>A programme that offers grants paid to local and foreign manufacturers starting new businesses</td>
</tr>
<tr>
<td>Skills Support Programme (SSP)</td>
<td>A cash incentive granted for skills development</td>
</tr>
</tbody>
</table>
9.2 Industrial development

9.2.1. Past and present approaches

- **Manufacturing development**: A method to advance economic development. It was the developmental approach previously used by South Africa. The manufacturing development approach relies on finance from foreign loans, aid and generous financial and other incentives received by business to drive economic development.

- **Industrial development**: The developmental approach being followed by South Africa at present. The developmental emphasis is shifted to services and agricultural activities, and the role of SMME’s is encouraged through supportive policies. The aim is to increase exports and increase employment, thus raising the local standard of living.

9.2.2. Best practice

Best practice industrial development policies include three principles:

- Rely on markets (comparative advantage)
- Fiscal and monetary self-discipline
- Global integration

9.2.3. Key sectors for development

Six sectors have considerable potential for output, export and job creation:

- **Exports**: Increase exports, e.g. of motorcars from South Africa

- **Tourism**: Increase the number of tourists coming to South Africa. Implement marketing strategies to market South Africa to the rest of the world

- **Agriculture**: A strategic plan has been jointly developed by government and organised agriculture to increase agricultural output.

- **Information and Communications Technology (ICT)**: South Africa has developed a competitive advantage in several areas of ICT.

- **Cultural industries**: Support the growth of the local cultural community, e.g. music.

- **Small business development**: Fills the gaps from primary, secondary and tertiary sectors left by large multi-national corporations.
9.3 Regional industrial development policies

Internationally there are two key benchmark aims of regional industrial development policies:
- Limit the effects of economic centralisation
- Promote regional development by using factors of production and infrastructure in underdeveloped areas

9.3.1. Best practices

These are the five best practices for regional industrial development policies:
- **Total development as a multi-dimensional process:** Treat development from a global perspective covering all dimensions of human living, including the interaction of social forces in a community, e.g. education, health, nutrition.
- **Development from within:** Establish independent development programmes. Focus on utilising local physical and human resources and energy. Developmental assistance from outside can still continue, but not where outside developmental programmes are forced upon the local people.
- **Development of people, for people, by people:** Regional development concerns people, and aims to serve the people of the region. Training, education, improving productivity and providing essential goods and services all raise the standard of living in regions. All people should be involved.
- **Development-from-below strategy:** Concentrates on issues at grassroots level where most urgent human needs exist. It starts by dealing with problems of poverty.
- **Cooperation between private and public sectors and the local community:** Ensure an integrated process; coordinate private and public sectors with the local community.
9.3.2. Provincial focuses

9.3.2A Spatial Development Initiatives (SDI’s):

- Government’s industrial policy strives towards a balance between open markets and promoting local competitiveness. It aims to open up the domestic economy to international competition.
- The Department of Trade and Industry (DTI) is the driving force behind industrial and spatial development.
- SDI initiatives rely on networking with other central provincial government departments to plan and monitor development. These include the Industrial Development Corporation (IDC), parastatals (like Telkom, Eskom and Transnet), and research institutions.
- Sustainable industrial development in areas where poverty and unemployment are at their highest remains a key policy.
- SDI’s focus on high-level support in areas where inherent economic potential exists but socio-economic conditions require concentrated government assistance.
- SDI’s goal is to fast-track investment and maximise synergies between various types of investments.
- There are 11 local SDI’s, including:
  - Industrial: KwaZulu-Natal and Fish River SDI
  - Agro tourism: Lubombo and Wild Coast SDI
  - Sectorial mix: Maputo Development Corridor
- The following corridors have been identified: Maputo, Coast to Coast, Wild Coast, Fish River and Richards Bay.

9.3.2B Industrial Development Zones (IDZ’s):

- There are four IDZs: Coega, Saldanha, East London and Johannesburg’s dry ports (City Deep and O.R. Tambo)
- IDZ’s located near major transport nodes (ports or airports) offer benefits to investing companies, such as:
  - Access to transport for exporting purposes
  - Waiver of duties for products produced for export
  - Subsidies for provision of skills training for employees
- Each IDZ is designed to:
  - Provide a location for the establishment of strategic investments
  - Promote and develop links between domestic and zone-based industries
  - Enable exploitation of resource-intensive industries

9.3.3. Incentives

Duty-free incentives are granted to IDZs and apply to businesses located in them:

- No duties are paid on imported goods.
- The incentives are designed to encourage domestic and foreign businesses to open in the IDZ and produce goods and services for export.

The following five programmes and grants are also offered as incentives to businesses locating in IDZs:

- Small and Medium Enterprise Development Programme (SMEDP)
- Skills Support Programme (SSP)
- Black Business Supplier Development Programme (BBSDP)
- Critical Infrastructure Programme (CIP)
- Foreign Investment Grant (FIG)
9.4. The suitability of South Africa's industrial development policies

9.4.1. National policy

The national policy follows international best practice:
• It promotes investment in physical and human capital.
• It encourages and promotes reconstruction and development.
• It supports technology by encouraging enterprises to apply scientific and technical knowledge.
• It enforces competitiveness by enhancing market efficiencies.
• It invests in physical infrastructure, including maintenance, improvement and expansion of infrastructure.

9.4.2. Regional policy

The regional policy is underpinned by most important international best practice principles: job creation, human development and macro- and microeconomic development. It focuses on:
• Workers-to-the-work: The priority is on employment creation. Workers have to move to where employment is.
• Work-to-workers: This is internationally regarded as the policy most likely to affect long-term problems of structural unemployment (unemployment resulting from a mismatch between demand in the labour market, and the skills and locations of workers).

Activity 1

Study the logos in Figure 1 and answer the questions that follow:

Figure 1: Logos

1. What government bodies do the acronyms in the logos stand for? (2)
2. Define the concept industrial development. (2)
3. Describe in your own words the important role of these institutions. (2)

Answers to activity 1

1. DTI – Department of Trade and Industry✓
   IDC – Industrial Development Corporation✓ (2)
2. Refers to policies that are aimed at the encouragement of industrial investment and greater industrial efficiency ✓✓ (2)
3. They promote industrial development in underdeveloped regions. ✓✓ (2) [6]
**Activity 2**

Discuss any two international best practices in terms of regional development. [8]

**Answers to activity 2**

1. **Total development as a multidimensional process**
   - This is a multidimensional perspective. It includes all dimensions of human living, including the interaction of social forces in a community, e.g., education, health, nutrition. [✓ ✓]

2. **Development from within**
   - This is endogenous or independent development. In the past, development programmes were forced upon regions. Now, regions strive for independence with development assistance from outside included in their strategies. Local physical resources, human resources, and energy are utilised. [✓ ✓] [8]

**Activity 3**

Explain the rationale of industrial development highlighting the past and present approaches. [8]

**Answers to activity 3**

1. **Past: Manufacturing development**
   - Manufacturing development is a method to advance economic development. It is financed by foreign loans, aid, and generous financial and other incentives received by businesses. [✓ ✓]

2. **Present: Emphasis has shifted to industrial development**
   - Services and agricultural activities – focus on role for SMMEs – policies continue to exist – aim to export, employ and raise standard of living. [✓ ✓] [8]

**Activity 4**

Study **Map 1** and answer the questions that follow:

1. Define the concept IDZ. (2)
2. List any TWO IDZ’s from the map. (2)
3. Mention the industry involved in TWO of the above mentioned IDZ’s. (2)
4. Discuss an incentive applied to businesses within the IDZ. (4)

**Map 1: Creating jobs. Industrial development zones**

- **Coega IDZ**
  - Motor industry
  - Jobs created: 7147
  - Value of investment to date: R2.1 billion

- **East London IDZ**
  - Jobs created to date: 930 manufacturing and related jobs
  - Value of investment to date: R1.3 billion

- **Johannesburg IDZ**
  - Still to be developed

- **Richards Bay IDZ**
  - The R670 million Taga terrochrome plant employs 300 people. Possible future investment of R400 million could create another 400 jobs.
Answers to activity 4

1. Industrial Development Zones are purpose-built industrial estates that are physically enclosed and linked to an international port or airport. ✓ ✓ (2)

2. Johannesburg, ✓ Richards Bay, ✓ East London ✓ and Coega ✓ (any 2) (2)

3. Coega = motor industry ✓ and Richards Bay = metal industry ✓ (2)

4. No duties are paid on imported goods. ✓ ✓ Designed to encourage domestic and foreign businesses to open in IDZ and produce goods and services for export ✓ ✓ (4)

Below is a list of suggested past exam questions for extra practice:

- SDI (2 marks) - February 2010, question 1.1.8
- CIP (2 marks) - February 2010, question 4.1.4
- IDC & PPP (data base 10 marks) - February 2010, question 4.3
- SDI & IDZ (50 marks) - February 2011, question 9
- SMME (2 marks) - November 2010, question 1.1.8
- IDZ (2 marks) - November 2011, question 1.1.7
- DBSA (2 marks) - November 2011, question 1.1.8
- Decentralisation (2 marks) - November 2011, question 4.1.3

CHAPTER 9 essay practise (Question 9):

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Discuss Spatial Development Initiatives (SDIs) and Industrial Development Zones (IDZs) as part of South Africa’s regional industrial development. In your discussion highlight the financial incentives of the state.
Protectionism refers to government policies and regulations (such as restrictive quotas and tariffs on imported goods), which are designed to benefit local producers of goods and services in their competition with imported goods, thus helping them to survive.

Free trade occurs where government creates very few barriers to international trade. This allows the free flow of goods and services into the country from any other country that can produce these goods cheaper, better, or in the required volumes.
## 10.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BRICS</strong></td>
<td>An association of emerging economies consisting of <em>Brazil, Russia, India, China</em> and <em>South Africa</em> set up to promote co-operation, policy coordination and political dialogue in international, economic and financial matters.</td>
</tr>
<tr>
<td><strong>Disinvestment</strong></td>
<td>Withdrawal of capital investment from a company or country.</td>
</tr>
<tr>
<td><strong>Embargo</strong></td>
<td>An official state ban on trade or other activities with a particular country.</td>
</tr>
<tr>
<td><strong>Export promotion</strong></td>
<td>Incentives to encourage the production of goods that can be exported. It is part of South Africa’s international trade policy.</td>
</tr>
<tr>
<td><strong>Free trade</strong></td>
<td>When producers and consumers are free to buy goods and services from anywhere in the world without the interference of government.</td>
</tr>
<tr>
<td><strong>Import substitution</strong></td>
<td>Goods that were previously imported are replaced with locally produced goods. It is part of South Africa’s international trade policy.</td>
</tr>
<tr>
<td><strong>MERCOSUR</strong></td>
<td>An organisation to promote free trade amongst <em>Argentina, Brazil, Paraguay</em> and <em>Uruguay</em>.</td>
</tr>
<tr>
<td><strong>New Partnership for African Development (NEPAD)</strong></td>
<td>Provides for regional cooperation and integration among African states.</td>
</tr>
<tr>
<td><strong>Protection</strong></td>
<td>A trade policy whereby the state discourages the importing of certain goods and services in order to protect local industries against unequal competition from abroad.</td>
</tr>
<tr>
<td><strong>Southern African Development Community (SADC)</strong></td>
<td>An economic and monetary union comprising <em>Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, SA, Swaziland, Tanzania, Zambia and Zimbabwe</em>, which allows imports from member states to qualify for duty-free access to other member states.</td>
</tr>
<tr>
<td><strong>Sanctions</strong></td>
<td>A penalty applied by one or more countries on another country.</td>
</tr>
<tr>
<td><strong>Trade liberalisation</strong></td>
<td>The abolition of government intervention in trade flows on both the import and the export side.</td>
</tr>
<tr>
<td><strong>World Trade Organisation (WTO)</strong></td>
<td>The international organisation that was created to monitor and liberalise international trade.</td>
</tr>
</tbody>
</table>
10.2 Import substitution

Import substitution is part of South Africa’s international trade policy. It occurs when locally produced goods replace goods that had previously been imported. This has a positive impact on the balance of trade.

10.2.1. Reasons for import substitution

Reasons for import substitution include the following:

- **Diversification:** It is easy to concentrate on an identified market to establish an industry in conditions of a protected domestic market.
- **Industrialisation is promoted:** Increased industrialisation contributes revenue to the treasury.
- **Balance of payments problems:** This will lead to import substitution and quotas.
- **Trade:** Developing countries rely on their natural resources as the basis for growth and development. Their exports consist of primary goods. Demand for these goods is fixed, there prices change continually and they have low income-generation potential.

10.2.2. Methods of import substitution

The government imposes certain measures to restrict the amount of imports into the country and to support local industries. Restrictive measures used to reserve the domestic market for local manufacturers are:

- **Tariffs:** Customs duties or import duties are taxes on imported goods. They can be ad valorem (based on the value) or specific to certain goods. Prices of imported goods increase for domestic consumers, and they tend to shift demand from imports to domestic products (goods).
- **Quotas:** Limits are put on the supply of goods and services. Supply is reduced and prices rise. Foreign enterprises benefit if demand for their products is remains high.
- **Subsidies:** They enable relatively high cost domestic enterprises to undercut more efficient foreign enterprises in the domestic market.
- **Exchange control:** Government reduces imports by limiting the amount of foreign exchange made available to those who wish to import.
- **Physical control:** A complete ban or embargo is imposed on the import of certain goods from a particular country.
- **Diverting trade:** Monetary deposits, time-consuming customs procedures and high-quality standards are imposed to make the importing of goods more difficult.
10.2.3. Advantages of import substitution

Some of the advantages of import substitution are:

- **Increased employment**: More local workers are employed. This stimulates the economy and GDP increases.
- **More choice**: Available foreign exchange can be used for other imports, thus increasing choices.
- **Diversification**: By producing more goods locally, the range of available goods increases, and the country becomes less vulnerable to foreign actions and conditions.

10.2.4. Disadvantages of import substitution

Some of the disadvantages of import substitution for the local economy are:

- **Capital and entrepreneurial talent**: This is drawn away from comparative advantage.
- **Technology borrowed from abroad**: This may be unsuitable for local production.
- **Competitiveness of certain sectors decreases**: Where comparative advantages exist.
- **Import substitution leads to demand for protection**: This demand comes from industries that provide inputs to local industries.

10.2.5. Skepticism about import substitution

Some people feel that import substitution should not happen, and the market should be left to its own devices. They feel that the disadvantages of import substitution outweigh the advantages. Their reasons include:

- **Protection means high profits for owners of protected industries. They are isolated and this leads to lower efficiency.**
- **Certain experts feel that it does not advance industrialisation.**
- **Consumers have to pay more for goods of inferior quality.**
10.3 Export promotion

Export promotion involves providing incentives to encourage local businesses to produce goods for export.

10.3.1. Reasons for export promotion

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

10.3.2. Methods of export promotion

Methods used to support export promotion include:
- **Incentives**: The government supplies information on export markets, research on new markets, concessions on transport charges, export credit, etc. in order to stimulate exports.
- **Subsidies**: These include direct and indirect subsidies:
  - **Direct subsidies**: Cash payments to exporters.
  - **Indirect subsidies**: Refunds on import tariffs and general tax rebates.
- **Trade neutrality**: Subsidies equal in size to import duties are paid. Neutrality can be achieved through trade liberalisation.

10.3.3. Advantages of export promotion

The advantages of export promotion include:
- There are no limitations to size of scale since the market is very large.
- Production is based on cost and efficiency.
- There is increased domestic production.
- Exchange rates would be realistic.

10.3.4. Disadvantages of export promotion

The disadvantages of export promotion include:
- The real cost of production is reduced by subsidies and incentives.
- The lack of competition because of incentives and subsidies forces competitors out of the market.
- Export promotion results in increased tariffs and quotas by powerful overseas competitors.
- Export promotion results in the protection of labour-intensive industries by developed countries.
10.4 Protection versus free trade

Many economists argue for protection, especially for developing countries. Many other economists insist that free trade is the best way to regulate markets. Governments often choose a mix of selected protectionist and free trade policies that suit the particular conditions of their country.

10.4.1. Arguments in favor of protection

- **For industrial development:** Some developing countries are well suited to establishing certain kinds of industries. Free trade makes it difficult for these countries to compete with countries with well-established industries.
- **Infant industries:** Newly established industries find it difficult to survive because of high average costs of production which are higher than those of well-established foreign competitors.
- **Stable wage levels and higher standards of living:** A country with high wages has a view that the standard of living will be undermined if cheaper goods are imported from countries with low wages.
- **The protection of job opportunities:** If local industries cannot find profitable markets because of cheaper imports, production may decrease and this will lead to more unemployment.
- **Economic self-sufficiency and strategic key industries:** In times of conflict, cut-off or friction between countries occurs. Protection should be granted, especially to key industries to ensure the availability of these key products.
- **Dangers of dumping:** Some countries sell their surplus goods in a foreign country at lower prices than it cost them to produce the goods. Local producers cannot compete, and their factories may close.
- **Stabilise exchange rates and balance of payments:** Traders buy in the cheapest markets and sell in the most expensive ones. Countries export primary products and import manufactured goods, causing disrupted balance of payments and exchange rates.

10.4.2. Arguments in favour of free trade

- The free trade argument is persuasive. If each nation does what it does best, everyone will enjoy lower prices and higher levels of output.
- Free trade leads to greater world production of traded goods, leading to an increase in economic welfare.
- Free trade allows countries to specialise in economic activities in which they have a comparative advantage (economies of scale).
- Free trade leads to mutual gains from international trade to all countries.
- When there is free trade, more efficient distribution of resources is possible because each country specialises in its most effective production.
- Free trade offers consumers greater choice. It allows consumers the choice of what to buy globally and not just from what is available locally.
10.4.3. A desirable mix of free trade and protection

- Although free trade arguments tend to dominate in theory, all nations impose restrictions on the international flow of goods, services and capital.
- Protectionists agree that economic losses occur with trade restrictions, but argue that non-economic benefits like job protection are more important economic losses.
- The World Trade Organisation (WTO) promotes free trade between countries.
Activity 1

Study the picture and answer the questions that follow:

1. Explain in your own words the meaning of ‘freedom to trade’? (3)
2. What does the slogan ‘trade not aid’ mean? (2)

Answers to activity 1

1. When international trade can take place globally without any restriction. ✓ ✓ ✓ (3)
2. People don’t want aid from rich countries but rather the opportunity to trade internationally. ✓ ✓ (2)

Activity 2

Choose the correct answer:
The following is an argument in favour of free trade: [2]
A. It protects infant industries.
B. It allows countries to specialise.
C. It prevents unemployment.

Answer to activity 2

B. It allows countries to specialise. ✓ ✓ (2)

Activity 3

Explain tariffs and quotas as methods for import substitution. [8]

Answer to activity 3

Tariffs are customs duties or import duties which are a form of taxes on imported goods. ✓ ✓. They can be ad valorem or specific. Prices of imported goods increase for domestic consumers, and they tend to shift demand from imports to domestic products (goods). ✓ ✓

Quotas are limits on the supply of goods and services. ✓ ✓. When supply is reduced, the price moves up. ✓ ✓. Foreign enterprises benefit from quotas if demand for their products remains high. ✓ ✓
Below is a list of suggested past exam questions for extra practice:

- **Dumping (2 marks)** - February 2010, question 1.1.9
- **Free trade (2 marks)** - February 2010, question 1.3.5
- **Quota (2 marks)** - February 2010, question 1.3.6
- **WTTC (2 marks)** - February 2010, question 1.3.7
- **Export promotion (2 marks)** - February 2010, question 4.1.3
- **Import substitution (6 marks)** - February 2010, question 4.2
- **Free trade (16 marks)** - February 2010, question 4.4
- **DTI (2 marks)** - February 2011, question 1.1.9
- **Free trade (2 marks)** - February 2011, question 1.2.3
- **Specific import duties (2 marks)** - February 2011, question 1.3.6
- **Import quota (2 marks)** - February 2011, question 4.1.3
- **WTO (2 marks)** - February 2011, question 4.1.4
- **AU (10 marks data base)** - February 2011, question 4.3
- **Free trade (8 marks)** - February 2011, question 4.5
- **SADC (2 marks)** - November 2010, question 1.1.7
- **Free trade (2 marks)** - November 2010, question 4.1.1
- **NEPAD (2 marks)** - November 2010, question 4.1.2
- **Free trade (6 marks)** - November 2010, question 4.2
- **DTI (10 marks data base)** - November 2010, question 4.3
- **Dumping (8 marks)** - November 2010, question 4.5
- **Protection (2 marks)** - November 2011, question 1.3.8
- **Dumping (2 marks)** - November 2011, question 1.2.1
- **Import substitution (6 marks)** - November 2011, question 4.2
- **SADC (10 marks)** - November 2011, question 4.3
- **Free trade (8 marks)** - November 2011, question 4.6

**CHAPTER 10 essay practise (Question 9):**

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Discuss **export promotion** as part of the South African international trade policy, briefly highlighting the effectiveness of the methods through which exports are promoted. (November 2010)
- Discuss the **arguments in favour of a policy of protection** and critically evaluate the South African international trade policies and major protocols regarding free trade. (November 2008)
- Discuss **export promotion** as part of South Africa’s foreign trade policy. (February 2012)
Economic and social indicators are useful tools to determine a country’s well-being. There are many economic and social indicators, including production, employment, education and demographic indicators.
## Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
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<tr>
<td>Consumer Price Index (CPI)</td>
<td>Measures changes over time in the prices of an average market ‘basket’ of consumer goods and services purchased by households</td>
</tr>
<tr>
<td>Economically Active Population (EAP)</td>
<td>All persons of either sex between the ages of 15 and 65 who supply labour for productive activities</td>
</tr>
<tr>
<td>International Monetary Fund (IMF)</td>
<td>An organisation working to promote employment, exchange rate stability, and international trade and economic cooperation by making financial resources available to member countries to meet their balance of payments needs</td>
</tr>
<tr>
<td>System of National Accounts (SNA)</td>
<td>Techniques which include double-entry accounting, for measuring the economic activity of a nation</td>
</tr>
<tr>
<td>United Nations Children’s Fund (Unicef)</td>
<td>An international body working for the development of children’s rights, and their survival and protection</td>
</tr>
<tr>
<td>World Bank</td>
<td>The international bank established to promote economic recovery and development</td>
</tr>
</tbody>
</table>
11.2 Economic indicators

Economic indicators (or business indicators) are statistics that allow you to analyse the economic performance and predict the future performance of the economy. There are 6 key economic indicators:

11.2.1. Monetary condition indicators

Money supply and interest rates affect prices and exchange rates directly.
- **Money supply**: This was previously the monetary target of the South African Reserve Bank (SARB). Currently the inflation target is used.
- **Interest rates**: The key interest rate is the repo rate. The government sells bonds at a price and agrees to purchase them later at a higher price. The percentage difference between these two prices is known as the repo rate.
- **Cash grants and services in kind**: These are provided to the poor in South Africa to help achieve the redistribution of income and wealth (e.g. affirmative action).

11.2.2. Production indicators

- **GDP at current prices**: This is the basic value indicator used in national accounts.
- **Real GDP**: The growth performance of a country is measured in terms of real GDP. The effect of inflation is removed.
- **Per capita real GDP**: This determines the average economic value of each individual by dividing the real GDP by the population. The per capita real GDP is used for:
- Comparing standard of living between countries.
- Indicating the importance of the different sectors in the economy.
- Comparing the standard of living between groups within a population.

11.2.3. Employment indicators

- **The economically active population** (EAP): The labour force between 15 – 65 years of age.
- **Employment**: The number of employed persons as a percentage of the economically active population (EAP), e.g. 73.5% in South Africa.
- **Unemployment**: The unemployed (who are actively looking for work) as a percentage of the economic active population.

11.2.4. Price change indicators

Price increases occur either because of scarcities of a product or changes in consumer preferences. Price increases over long periods of time are known as inflation.

There are two key price change indicators:
- **Producer Price Index (PPI)**: This is the indicator used to measure an increase or decrease over time in the prices of goods produced locally when they leave the factory floor; and an increase or decrease in the price of imported goods.
- **Consumer Price Index (CPI)**: Weights are obtained from the expenditure of households and show changes in the purchasing power of the rand. This is the official index used in inflation targeting.

11.2.5. Foreign trade indicators

International trade is important in a globalised world. Exports stimulate employment and imports widen the choice of consumers.

- **Terms of trade**: The ratio of export and import prices. If the ratio deteriorates (gets worse), a greater volume of exports must be produced that may cause a spill-over effect into the balance of payments.
- **Exchange rate**: The value of one country’s currency in relation to another country’s currency.

11.2.6. Productivity indicators

Labour productivity is watched very closely, particularly in relation to real wage increases.

- **Labour productivity**: This is measured by dividing the real GDP by the number of workers employed.
- **Remuneration per worker**: If productivity increases are lower than the real wage increases, inflationary pressures will occur.
11.3 Social indicators

Social indicators are concerned with people. They monitor identifiable and definable issues related to human well-being over a period of time. There are 7 key social indicators:

11.3.1. Income distribution indicators

- **Gini coefficient**: This shows the distribution of income. Its value varies between 0 and 1. The higher the value, the more unequal the distribution of income. Progressive income tax and BEE are methods used to redistribute income and lower the Gini coefficient.
- **Head count index**: The percentage of people living on an income of less than the poverty line. This has been determined internationally by the World Bank and is equal to $1 per day, depending on the level of development.

11.3.2. Demographic indicators

The size of the population is important for infrastructure and social programmes.

- **Population growth**: The population numbered 46.8 million in 2005. Growth is slowing down. Measuring population growth is important for delivering social services and for identifying the size of the tax base (the total number of people paying taxes).
- **Life expectancy**: South Africa’s life expectancy rate is down from 62.8 years to 47 years.

11.3.3. Nutrition and health indicators

The standard of living of the population is related to the quality of nutrition and health:

- **Nutrition**: It is important that infants and young children eat enough healthy food (weight and height are indicators used to measure this).
- **Health**: Infant mortality (the number of children dying before one year of age) is one way of measuring the health of a population.
- **Drinking water and sanitation**: The quality of drinking water and sanitation are important indicators of a country’s health.
### 11.3.4. Education indicators

The standard of living is related to the level of education. Education is a key social indicator:

- **Public expenditure**: The percentage of the national budget that is directed towards education.
- **Secondary enrolment**: This shows the percentage of an age group attending high school.
- **Primary completion**: The percentage of an age group that has completed primary education is an indicator of the efficiency of the education system.
- **Youth literacy rate**: The percentage of the 15–24 age group that are literate.

### 11.3.5. Housing and services indicators

The standard of living of the population is related to the quality of their housing and services:

- **Housing**: Many South African citizens are poor and cannot afford property. The government supplies housing subsidies and the private sector provides housing loans.
- **Services**: The extent and quality of electricity, refuse disposal and RDP housing.

### 11.3.6. Urbanisation indicators

The level of urbanisation is one of the indicators of a country's social development.

- An increase in population numbers in the cities is due to natural growth, and national, local and international migration.
11.4 International comparisons

International comparisons are the key means of measuring a country’s economic and social development.

11.4.1. Globalisation

- **International trade**: Payments are affected by the exchange rate.
- **Internationalisation**: Branch offices in foreign countries monitor indicators to publish financial reports in a single currency and pay dividends in different currencies.

11.4.2. International standardisation

- Economic and social indicators are useful. International organisations, like the World Bank and the IMF, are very specific in determining, utilising and applying these indicators.
- Benefits from organisations cannot be measured if indicators are not available, e.g. bridging finance from the IMF, World Bank and the UN.

11.4.3. Aid and assistance

- Foreign countries, governments, international institutions and NGOs are globally involved in providing financial aid.
- A country needs indicators, including domestic income, production and expenditure, poverty, education and health data, to receive aid and to measure the impact of this aid.
- Human rights (children’s rights), environment (pollution) and governance (corruption) indicators might also be requested by aid organisations.

11.4.4. Comparisons and forecasting

- Capital markets are liberated through globalisation.
- Capital moves where it receives the best returns.
- Publications for global players give indicator values for the 3 previous and 3 future years to spot underlying trends.

**Activity 1**

Choose the correct word between brackets:

1. The key rate of interest in SA is the (repo/exchange) rate. (2)
2. The growth performance of a country is measured in terms of the (per capita real GDP/increase in the real GDP). (2)
3. The economically active population is the labour force between 15 and (55/65) years of age. (2)
4. The index used to determine the prices of inputs is called the (consumer/producer) price index. (2)
5. Social indicators are concerned with people, such as education and (corruption/health). (2) [10]

NB! Learn these four points that are used by international organisations to measure a country’s level of economic and social development.
**Answers to activity 1**

1. Repo rate ✓ ✓
2. Increase in the real GDP ✓ ✓
3. 65 ✓ ✓
4. Producer ✓ ✓
5. Health ✓ ✓

[10]

**Activity 2**

Give ONE answer for each of the following.

1. An international bank established to promote economic recovery and development (2)
2. Used to establish the performance of the economy in terms of basic economic objectives of growth, price stability, exchange rate stability and full employment (2)
3. It is depicted in the Lorenz curve and shows the distribution of income (2)
4. The price of one country’s currency in terms of another country’s currency (2)
5. Ratio of export and import prices (2)

[10]

**Answers to activity 2**

1. World bank ✓ ✓
2. Economic indicator ✓ ✓
3. Gini coefficient ✓ ✓
4. Exchange rate ✓ ✓
5. Terms of trade ✓ ✓

[10]

**Activity 3**

Distinguish in tabular form between the Consumer Price Index and the Producer Price Index. (2 × 4) [8]

<table>
<thead>
<tr>
<th></th>
<th>PPI</th>
<th>CPI</th>
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<tbody>
<tr>
<td>Producer Price Index: an index that assesses the impact of changes ✓ in the relative weighting of production inputs ✓</td>
<td>Consumer Price Index: an index that measures the price ✓ of a fixed basket of consumer goods and services ✓.</td>
<td></td>
</tr>
<tr>
<td>• Relates to the cost of production ✓</td>
<td>• Relates to the cost of living ✓</td>
<td></td>
</tr>
<tr>
<td>• Basket consists of goods only ✓ ✓</td>
<td>• Basket consists of consumer goods and services ✓ ✓</td>
<td></td>
</tr>
<tr>
<td>• Capital and intermediate goods are included ✓ ✓</td>
<td>• Capital and intermediate goods are excluded ✓ ✓</td>
<td></td>
</tr>
<tr>
<td>• Prices exclude VAT ✓ ✓</td>
<td>• Prices include VAT ✓ ✓</td>
<td></td>
</tr>
<tr>
<td>• Interest rates are excluded ✓ ✓</td>
<td>• Interest rates are taken into account ✓ ✓</td>
<td></td>
</tr>
<tr>
<td>• Prices of imported goods are shown explicitly ✓ ✓</td>
<td>• Prices of imported goods are not shown ✓ ✓</td>
<td></td>
</tr>
</tbody>
</table>

[8]
Below is a list of suggested past exam questions for extra practice:

- Economic indicators (2 marks) – February 2010, question 1.2.4
- Social indicators (50 marks) – February 2010, question 10
- Economic indicator (2 marks) – February 2011, question 1.1.8
- Economic indicators (10 marks – data base) – February 2011, question 6.4
- Social indicators (2 marks) – November 2010, question 4.1.4
- Economic indicators (10 marks) – November 2010, question 6.4
- Economic indicators (50 marks) – November 2010, question 9
- Economic indicators (50 marks) – November 2011, question 9

CHAPTER 11 essay practise (Question 9):
Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Analyse and discuss the South African key social performance indicators and their uses. (November 2010)
- Discuss and assess the economic indicators as depicted below, in terms of the state of the South African economy.

<table>
<thead>
<tr>
<th>ECONOMIC INDICATORS MEASURE THE PERFORMANCE OF THE ECONOMY</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>R(GDP) – % change</td>
<td>-2%</td>
<td>-6%</td>
</tr>
<tr>
<td>PER CAPITA R(GDP)</td>
<td>R22 622</td>
<td>R23 403</td>
</tr>
<tr>
<td>CPI</td>
<td>9,0%</td>
<td>6,2%</td>
</tr>
<tr>
<td>REPO RATE</td>
<td>10,5%</td>
<td>7,5%</td>
</tr>
<tr>
<td>Gini Coefficient</td>
<td>57,8</td>
<td>57,8</td>
</tr>
</tbody>
</table>

[Economic Indicators for South-Africa, Quarterly Bulletin SARB, June 2009]

- Discuss the following economic indicators, which are used in measuring the performance of the economy:
  - Production (real GDP)
  - Employment/Unemployment
  - Money supply
  - The inflation rate (CPI)

Keep going!
Inflation occurs when there is a sustained and significant increase in the general price level over a period of time. At the same time, there is a decline in the buying power of money, i.e. the general price level increases more than the general increase in wages or salaries.
# 12.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administered prices</td>
<td>Prices set or controlled by government</td>
</tr>
<tr>
<td>Core inflation</td>
<td>Excludes items from the CPI basket that are highly volatile or prices affected by government policy</td>
</tr>
<tr>
<td>Cost push inflation</td>
<td>Occurs when there is an increase in the general price level caused by an increase in the cost of production</td>
</tr>
<tr>
<td>Consumer Price Index (CPI)</td>
<td>An index that measures the price of a fixed basket of consumer goods and services</td>
</tr>
<tr>
<td></td>
<td>• Relates to the cost of living</td>
</tr>
<tr>
<td></td>
<td>• The basket consists of consumer goods and services</td>
</tr>
<tr>
<td></td>
<td>• Capital and intermediate goods are excluded</td>
</tr>
<tr>
<td></td>
<td>• Prices include VAT</td>
</tr>
<tr>
<td></td>
<td>• Interest rates are taken into account</td>
</tr>
<tr>
<td></td>
<td>• Prices of imported goods are not shown</td>
</tr>
<tr>
<td>Demand-pull inflation</td>
<td>Occurs when the aggregate demand for goods and services exceeds the aggregate supply of goods and services</td>
</tr>
<tr>
<td>Headline inflation</td>
<td>Unadjusted CPI figures</td>
</tr>
<tr>
<td>Hyper-inflation</td>
<td>An inflation rate above 50%. People lose confidence in the value of money and start bartering goods and services</td>
</tr>
<tr>
<td>Inflation</td>
<td>A sustained and significant increase in the general price level over a period of time; and a simultaneous (at the same time) decline in the buying power of money</td>
</tr>
<tr>
<td>Inflation targeting</td>
<td>Forms part of monetary policy set by government and is managed by the Reserve Bank to keep inflation within the range as set by the Minister of Finance (between 3% and 6%)</td>
</tr>
<tr>
<td>Monetary Policy Committee (MPC)</td>
<td>Consists of the Governor of the 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</td>
</tr>
<tr>
<td>Producer Price Index (PPI)</td>
<td>Assesses the impact of changes in the relative weighting of production inputs:</td>
</tr>
<tr>
<td></td>
<td>• Pertains to the cost of production</td>
</tr>
<tr>
<td></td>
<td>• The basket consists of goods only</td>
</tr>
<tr>
<td></td>
<td>• Capital and intermediate goods are included</td>
</tr>
<tr>
<td></td>
<td>• Prices exclude VAT</td>
</tr>
<tr>
<td></td>
<td>• Interest rates are excluded</td>
</tr>
<tr>
<td></td>
<td>• Prices of imported goods are shown explicitly</td>
</tr>
<tr>
<td>Stagflation</td>
<td>Low growth, high unemployment and high inflation rates</td>
</tr>
</tbody>
</table>
12.2 Types of inflation

There are two main types of inflation – demand-pull inflation and cost-push inflation. Their characteristics are described below:

12.2.1. Demand-pull inflation

Demand-pull inflation occurs when aggregate demand in an economy outpaces (is faster than) aggregate supply, even though gross domestic product rises and unemployment falls. Effectively, too much money is spent chasing too few goods. Generally, an increase in the supply of demanded goods will reverse the inflationary trend. Some of the characteristics of demand-pull inflation are:

- Aggregate demand rises more than aggregate supply, causing an increase in the general price level.
- Groups that are responsible: Consumers, businesses and government.
- Foreigner’s contribution: They further increase the demand for our goods and services.
- Relative increase in aggregate demand’s components: C (consumption spending), I (investment spending), G (government spending), M (cost of imports).

12.2.1.A The causes of demand-pull inflation

There are many causes of demand-pull inflation. Some of these are below:

- The working of the market mechanism: Large demand and small supply pushes prices up.
- The public is not savings-conscious: They spend all their disposable income.
- There are not enough savings to finance very important capital investment. It causes supply to decrease.
- Spending patterns become extravagant (e.g. luxury hotels).
- Public spending increases without increased productivity: There is excessive demand for infrastructure (roads), consumption spending (education), and social spending (public works programmes).
- An increase in the money supply without increased production causes excess demand.
- Easy credit causes demand inflation.
- Higher exports without an increase in domestic production.
- A reduction in taxes (personal income tax).
- Investment spending: Lower interest rates and higher profit expectations lead to investments.
12.2.2. Cost-push inflation

Cost-push inflation is caused by an increase in the cost of goods or services that are very important to the economy, and for which no alternatives exist. Examples can be spikes in the oil price due to war, huge price rises in essential food products due to drought, or excessive increases in the cost of labour due to control of industries by trade unions. Some of the characteristics of cost-push inflation are:

- An increase in labour costs: Aggressive trade union negotiations push the price of labour up above the increase in productivity.
- Producers increase profits: Prices rise more than the rise in production costs.
- The state imposes a higher VAT rate
- Expensive imported products (intermediate goods) cause an increase in the prices of locally finished goods.
- Lower productivity but the same remuneration: The cost of production increases.
- Natural disasters: Floods or droughts increase the cost of production.
- Increased total costs on the supply side.

12.2.2.A The causes of cost-push inflation

There are many causes of cost-push inflation. Some of these are below:

- Workers demand wage increases larger than their increase in productivity: Costs are recovered by increased prices. This causes a vicious circle – higher wages, higher prices, and a higher cost of living.
- A drop in productivity while employment and wages remain constant.
- Strikes and stay-aways reduce production.
- Direct taxation increases and products become more expensive.
- Exchange rate depreciation: Indirect taxation (e.g. customs and excise duties) which increases the price of goods and services.
- Key inputs: Prices of imports rise, which increases the cost of production.
- Administered prices increase, e.g. petrol (controlled by the state).
- Price increases intended to increase profit margins of businesses without excess demand.
- Shoplifting and losses caused by employees are added to the price of all products.
- High prices of agricultural goods due to the high cost of inputs (e.g. diesel and fertilisers) leads to higher food prices.
- High interest rates are a cost item for businesses and are included in prices.
- Natural disasters: droughts, floods and global warming increase costs.
12.2.5. The consequences of inflation

Inflation causes the general population to become poorer. Inflation has many consequences. Some of these are:

- **The purchasing power of money decreases**: The monetary unit loses its function as a measure of value.
- **Income and wealth are redistributed**:
  - Creditors suffer due to price increases while debtors benefit from price increases.
  - Salary and wage earners suffer because their income remains constant.
  - Investors: Assets with fixed values decrease while assets with flexible market values increase.
- **Entrepreneurs** benefit because they can increase profit margins more than costs.
- **Savings** will decrease as the real value of money drops (purchasing power).
- **Government**: South Africa's progressive income tax leads to a bracket creep that results from a combination of inflation and progressive income tax.
- **Industrial and social unrest**: Wage bargaining, strikes and mass action affects society.
- **Economic growth is negatively affected**: Uncertainty in the economy increases. This discourages savings and investment, which tends to be short-term and speculative.
- **It undermines confidence** and creates an unfavourable climate for economic activities.
- **It is harmful for free enterprise**: Prices no longer indicate the correct scarcity value of goods and services.

12.3 Measures to combat inflation

The government, normally through the actions of the South African Reserve Bank, takes measures to combat inflation when inflation grows too high. Three kinds of measures are described below:

**SUMMARY**: Fiscal policy makes use of tax increases and spending cuts to combat inflation.

### 12.3.1. Fiscal measures

Fiscal measures are measures taken by the Minister of Finance regarding taxation and expenditure. Examples of measures that can be taken include:

- An increase in **direct taxation** (personal income tax) due to excess demand for goods.
- An increase in **indirect taxation** (VAT) causes spending to decrease because goods become more expensive.
- A **loan levy**.
- **The state cuts back on expenditure** by cancelling government projects like roads, hospitals and schools.
- **The country's finance budget deficit is non-inflationary** (the government uses loans from the non-banking sector to limit inflation).
- **The state imposes surcharges** on imported goods. This increases the price of these imported goods, resulting in many people being unable to afford to buy these goods.
12.3.2. Monetary measures

The South African Reserve Bank (SARB) and the government apply certain monetary measures to curb inflation:

- The SARB adjusts the quantity of money to the needs of the economy, (e.g. through open-market policy, thus maintaining a fine balance) between the supply of goods and services and money supply.
- The SARB curbs inflation caused by excess demand by reducing the money supply.
- The bank rate of the central bank (SARB) affects the interest rates in the economy (repo rate). The bank rate can be raised to encourage savings.
- Excessive credit can be reduced by restricting the granting of credit by banks.
- The SARB can apply moral pressure (moral suasion) on financial institutions to be more careful when granting credit.

12.3.3. Other measures

Additional measures that can be taken to combat inflation include:

- Increase productivity: This is a long-term measure generated through improved education and training which allows more people to be employed and ensures they are more productive.
- Price control: By fixing the price of certain essential goods, the government assures they remain affordable.
- Wage policy: The government takes a decision to break the inflationary spiral of increased wages and prices by keeping the increase in wages below or at the level of inflation.
- Stricter conditions for consumer credit: The government makes it harder for consumers to get credit in order to restrict their spending.
- Encourage personal savings: The government implements measures to encourage savings, e.g. by cutting taxes on savings. The imbalance between demand and supply is corrected by increased savings, as people save more and spend less.
- Import controls are relaxed.
- Floating exchange rate: Prices are automatically adjusted to international conditions.
- Indexation: The effects of inflation should be lessened – learn to live with inflation.

Use the following word acronyms to help you remember these additional measures to combat inflation:

<table>
<thead>
<tr>
<th>W</th>
<th>Wage</th>
<th>S</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Import</td>
<td>C</td>
<td>Credit</td>
</tr>
<tr>
<td>P</td>
<td>Productivity</td>
<td>I</td>
<td>Indexation</td>
</tr>
<tr>
<td>E</td>
<td>Exchange rate</td>
<td>P</td>
<td>Price</td>
</tr>
</tbody>
</table>
Activity 1

Study graph 1 below and answer the questions that follow:

Graph 1

1. Define the concept inflation. (2)
2. When did the inflation rate peak? (2)
3. Do we adhere to the inflation target set by government from July 2010–Jan 2011? Supply figures. (4)
4. Explain what you would do to lower the inflation rate in our country? (4)
5. Which institution in South Africa makes inflation figures available? (2)
6. What, according to you, caused the double figures in April–July 2008? (4)
7. Why are these figures in the graph not a reflection of hyperinflation? (4)

Answers to activity 1

1. A sustained and significant increase in the general price level over a period of time. ✓ ✓ ✓ (2)
2. July 2008 ✓ ✓ ✓ (2)
3. Yes ✓ ✓ ✓ Inflation target between 3 – 6 % ✓ ✓ ✓ (4)
4. Apply monetary (repo rate) ✓ ✓ ✓ and fiscal policies (tax increases) ✓ ✓ ✓ (4)
5. SARB ✓ ✓ ✓ (2)
6. Excessive consumer spending, ✓ ✓ ✓ Due to the capital expenditure by the state for the Soccer World Cup ✓ ✓ ✓ (4)
7. Hyperinflation starts at 50% ✓ ✓ ✓ ✓ ✓ (4)
Activity 3

Study the cartoon below and answer the questions that follow:

Before inflation - she goes to the market carrying her money in her POCKET-BOOK

And brings her groceries home in a BASKET

After inflation - she carries her MONEY in a basket, and.....

Brings her GROCERIES home in her POCKET-BOOK

1. What is the message behind the cartoon? (2)
2. What is happening to the purchasing power of the money? (2)
3. In which country is this woman a consumer? Motivate your answer. (4)

Answers to activity 2

1. Due to inflation, the consumer can buy less for the same amount ✓✓ (2)
2. Declining ✓✓ (2)
3. USA ✓✓ She is carrying US Dollars ($) in her basket ✓✓ (4)

Answers to activity 3

Name any THREE fiscal measures to control inflation. (3 × 2) [6]

Increase direct taxation (personal income tax) if inflation is due to excess demand ✓✓
- Increase indirect taxation (VAT) ✓✓
- A loan levy is introduced ✓✓
- The state cuts back on expenditure ✓✓
- The finance budget deficit is non-inflationary ✓✓
- Impose surcharges on imported goods ✓✓ (any 3) (3 × 2) [6]
Below is a list of suggested past exam questions for extra practice:

- **Inflation rate (2 marks)** – February 2010, question 1.1.10
- **Prices increase (2 marks)** – February 2010, question 5.1.4
- **Kinds & characteristics & measures (50 marks)** – February 2010, question 10
- **Deflation (2 marks)** – February 2011, question 1.1.11
- **Inflation target (2 marks)** – February 2011, question 1.2.4
- **Causes of inflation (2 marks)** – February 2011, question 5.1.3
- **Headline and CPI (8 marks)** – February 2011, question 5.5
- **Buying power (2 marks)** – November 2010, question 1.1.10
- **CPI (2 marks)** – November 2010, question 1.3.8
- **Demand inflation** – November 2010, question 5.1.1
- **Deflation (2 marks)** – November 2010, question 5.1.2
- **Characteristics of cost push (16 marks)** – November 2010, question 5.2
- **Inflation (10 marks)** – November 2010, question 5.4
- **Hyper & stagflation (8 marks)** – November 2010, question 5.6
- **Hyper inflation (2 marks)** – November 2011, question 1.1.10
- **Inflation target (2 marks)** – November 2011, question 5.1.1
- **Inflation rate (10 marks)** – November 2011, question 5.4
- **Causes and consequences of inflation (50 marks)** – November 2011, question 10

CHAPTER 12 (Question 10):

Essay writing is an important skill needed to succeed in Economics exams. Please refer to page vii in the introduction for more information about essays in Grade 12 Economics exams. The following questions have been included in past papers. Practise your essay writing skills by answering each of them:

- Write an essay on the different **kinds and characteristics of inflation**, highlighting the measures applied by the SARB to combat inflation. (November 2010)
- Discuss the **causes and consequences of demand-pull inflation**. (November 2011)
- Explain the **causes and impact of inflation** on the poorest of the poor. Suggest possible measures to combat inflation. (November 2008)
Tourism is travel for the purpose of leisure, recreation or business. Local tourists travel to different places in their own country. Inbound tourists come to South Africa from other countries. South African tourists who travel overseas are known as outbound tourists. South Africa is a popular tourist destination because of its beauty, wildlife, good weather and its interesting political history.
13.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well. Use mobile notes to help you remember them.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic tourist</td>
<td>South African citizens travelling within the borders of South Africa</td>
</tr>
<tr>
<td>Department of Tourism</td>
<td>Ensures and accelerates (speeds up) the delivery of tourism benefits</td>
</tr>
<tr>
<td>Foreign tourist</td>
<td>Visits a foreign country as a destination</td>
</tr>
<tr>
<td>Inbound tourist</td>
<td>Tourists from other countries (foreign tourists) who stay for more than one day</td>
</tr>
<tr>
<td>Outbound tourist</td>
<td>South African citizens travelling abroad. They have the same effect as imports on the balance of payments</td>
</tr>
<tr>
<td>Tourism</td>
<td>Activities of people travelling to and staying in places outside of their usual environment for no more than one year for leisure, business and other purposes. It does not relate to any work done for money in the place visited</td>
</tr>
<tr>
<td>Transit tourist</td>
<td>Tourists travelling through South Africa using air, road, rail and sea transport to get to another destination</td>
</tr>
</tbody>
</table>
13.2 The reasons for and role of tourism

Tourists travel to foreign countries for holidays, business, conferences and to discover more about other countries. Tourism allows people to experience the world.

13.2.1. What is tourism?
An activity is seen as tourism if it fits in with the following criteria:
- There is a purpose for the visit or activity
- There is no remuneration (money) earned in the place visited
- A minimum length of stay is one night
- A maximum length of stay is one year
- There is a travelling distance of more than 160km from the tourist’s home environment

13.2.2. The reasons for tourism
- **Leisure and recreation**: Tourists come to South Africa on holiday, to play sport, to visit friends, and to see the tourist attractions
- **Cultural tourism**: Tourists come to visit museums and art galleries, e.g. Robben Island and the Apartheid Museum
- **Ecotourism**: Tourists visit undisturbed natural areas, e.g. the Richtersveld Cultural and Botanical Landscape, the Cape Floral Region Protected Areas and the Kruger National Park
- **Business and professional**: Tourists visit for business meetings and conferences

13.2.3. The role of tourism
Tourism offers unique experiences to a wide range of consumers away from their homes.
- Tourism plays a vital role in the world economy. It is the largest and fastest growing industry.
- Tourism has a marked impact on economic growth, employment, foreign currency earnings and economic stability.
- Tourism is the largest generator of jobs worldwide.
- The tourist industry involves various suppliers in many sectors of the economy.
13.2.4. A South African tourism profile

South Africa has a wealth of indigenous (local) knowledge and is famous internationally for its world heritage sites.

Indigenous knowledge:
- Tourists want to understand the indigenous (local) culture, history and environment.
- Tourists seek authentic (genuine) and unique destinations. They want to see how local people live and work.
- The Khoi San are among the worlds’ oldest people, and their way of life is of interest to many foreign tourists.

World Heritage Sites:
- South African World Heritage Sites include the Sterkfontein Caves (the ancient skull of Mrs Ples and the Cradle of Humankind); the Mapungubwe Cultural Landscape in Limpopo; and the Vredefort Dome (meteorite) in the North West.
- Many of these sites offer insights into the origins of humankind.

Environmental World Heritage Sites:
- South African environmental World Heritage Sites include iSimangaliso Wetlands Park in KwaZulu-Natal (it has 5 different ecosystems); Ukhahlamba Drakensberg Park in KwaZulu-Natal; and the Cape Fynbos Region (Table Mountain and Agulhas National Park in the Western Cape).
- These sites offer unique environments with plant, insect or animal life that may not exist anywhere else in the world.

13.3 The effects of tourism

Tourism has a significant effect on the economy and the country as a whole. The following 6 areas are greatly affected by tourism:

13.3.1. Employment
- Tourism employs 7% of South Africa’s workforce (approximately 1.12 million people).
- Tourism is the largest provider of jobs because it:
  - Is labour intensive.
  - Employs many different kinds of skills, e.g. tourist guides, hotel staff.
  - Provides immediate employment.
  - Provides entrepreneurial opportunities.
- Tourism is the largest earner of foreign exchange because:
  - Foreign tourists pay for services in foreign exchange.
  - Foreign tourists usually spend more than local tourists.
13.3.2. Gross domestic product (GDP)

- Tourism has the biggest impact on the services industry.
- Indirect contribution: Tourism is a service-based industry. It is responsible for 65% of the GDP in developed economies and 40% of the GDP in developing countries.
- Direct contribution: Tourism contributes 7.9% of GDP in South Africa (compared to 12% worldwide).

13.3.3. Poverty

Poverty is most evident in rural areas due to a lack of job opportunities. Tourism can alleviate (ease) poverty in the following ways:

- Tourism is a fast and effective mechanism for distributing resources to rural areas to develop them as tourist sites.
- Many prime tourist attractions are located in rural areas.
- Tourist developments in rural areas increase the number of available jobs in areas where there aren’t many jobs.
- Tourism promotes a balanced and sustainable form of development. People are able to earn a living in their home areas, resulting in a reduction in urbanisation and a more balanced population distribution.

13.3.4. Externalities

Externalities are costs and benefits that have not been foreseen. Tourism externalities have both positive and negative effects:

**Positive externalities:**
- Tourism attracts large amounts of revenue.
- A rapid growth in tourism has short-term revenue benefits (money is quickly earned).
- Global tourism will grow due to an increased world population, leading to increased revenue collection.
- Tourism can help conserve cultural and natural assets and alleviate poverty, but needs to be carefully planned.

**Negative externalities:**
- Tourism can cause environmental damage if not managed correctly.
- Tourism can result in a lot of waste and damage to sensitive tourist sites.
- The infrastructure at tourist sites can come under pressure to cater for increased tourist numbers.

13.3.5. The environment

Tourism can create environmental stress. It can result in:

- Permanent restructuring of the landscape, e.g. construction work on highways.
- Additional waste products, e.g. biological (sewage) and non-biological (litter) waste.
• Direct environmental stress, e.g. the loss of wildlife species due to safari hunting.
• Effects on population dynamics, e.g. migration and changes in population density in response to the needs of tourist sites.

13.3.6. Infrastructure
Tourist destinations require adequate physical (hotel rooms), economic (ATMs) and basic (water and electricity) services infrastructure. This includes:

Transport infrastructure, e.g. improved roads are needed to access tourist sites.

Communication infrastructure, e.g. hotels need telephone lines to take bookings at tourist sites.

Energy infrastructure, e.g. tourists need electricity at tourist sites.

13.4 The benefits of tourism
South Africa benefits from tourism through the growth in the gross domestic product (GDP), employment and infrastructure development. An additional benefit is that spending by foreign tourists results in an increase in foreign exchange earnings, which has a similar impact on the GDP to an increase in exports.

13.4.1. Households
Tourism benefits a household’s prosperity (wealth) in three ways:
• More people earn salaries and wages because of additional job opportunities.
• Infrastructure built for tourists is available both for tourists and local people’s use.
• Skills: A variety of skills are required in the tourism industry.

13.4.2. Businesses
Tourism has many benefits for the business sector:
• The economic and basic services infrastructure required for tourism is provided by the public sector.
• Tourism needs superstructure, which consists of businesses that provide accommodation, transport, built attractions, retailing and recreation services.
• Superstructure is normally supplied by the private sector, and the building and running of the superstructure makes profits.
• Public and private sector partnerships (PPP’s) are used to develop tourist destinations.
• Other work opportunities become available for the previously disadvantaged. These include:
Employment opportunities in entertainment, laundry and transportation.
Business opportunities in car rental, arts, craft and curio sales.

13.4.3. Government
The main benefit to government is in the levying (charging) of taxes. This has two purposes:
- **To recover external costs:** To compensate the host community for providing infrastructure.
- **To raise revenue:** Tourists are seen as part of the overall tax base (e.g., airport departure taxes and hotel tourism levies increase the amount of taxes collected).

13.4.4. Infrastructure
South Africa benefits from tourism because all infrastructure built to support tourism becomes an asset to the country. As a result:
- Residents and visitors enjoy adequate and well-maintained physical and basic services infrastructure.
- The Department of Transport prioritises economic infrastructure. Spatial Development Initiatives and economic corridors focus on tourism, and public and private sector partnerships (PPPs) are used for the development of infrastructure.
- Tourists require social infrastructure – ambulances, medical clinics, police protection services and information services – that becomes a national asset.

13.5 Tourism policy initiatives
The Department of Tourism leads and directs tourism policy. The starting point for policy on tourism is the White Paper on Tourism. Tourism policy is also supported and directed by the Tourism Forum, which is an advisory body to the Minister of Tourism. Some tourism policy initiatives include:

13.5.1. Marketing
SA Tourism was created to promote tourism internationally and nationally:
- **Nationally:** SA Tourism persuades South African citizens to travel in their own country.
- **Internationally:** Marketing initiatives try to ensure South Africa is selected as a tourist destination. Foreigners visit our country for the following reasons:
  - Value for money
  - The world in one country
  - South Africa’s political miracle
  - The climate
  - Safety
  - The friendliness of South Africa’s people
  - The cleanliness and tranquility (peace) of our tourist destinations
13.5.2. Directing tourists
spatial distribution

Three approaches are followed to distribute tourists effectively to the many tourist sites:
• **Create representative bodies**: Tourist-based industries are linked to form representative bodies. Tourists can then easily access knowledge about all tourist destinations.
• **Improve marketing**: Tourists receive accurate product descriptions and information about competitive prices. Less well-known destinations are aggressively marketed.
• **Improve supporting services**: The standards of transport, accommodation and other amenities (facilities and services) are world class.

13.5.3. Taxation

Growth in tourism results in increased tourist taxes. Guidelines for levying taxes are:
• **Equity**: Taxes must be fair, e.g. taxes on air tickets.
• **Efficiency**: Nature and game reserves charge entry taxes to regulate tourist flows.
• **Simplicity**: A flat tax rate is used to ensure taxes are easy to pay and administer.

13.5.4. Infrastructure

Tourism requires economic infrastructure (roads), social infrastructure (ambulances) and basic services (clean water):
• Infrastructure is maintained for the benefit of domestic and foreign tourists, as well as local citizens.
• The basic considerations are:
  – More infrastructure is required, e.g. water supplies.
  – Existing infrastructure must be upgraded, e.g. upgrade dirt roads to tarred roads.
  – Use new technology to extend the infrastructure, e.g. build the Gautrain.
Activity 1

Study the diagram below and answer the questions that follow:

1. Define the concept tourism. (4)
2. Explain the difference between an inbound and an outbound tourist. (4)
3. List any THREE World Heritage Sites. (3)
4. Discuss the effect of tourism on infrastructure. (4 × 2) (8)

Answers to activity 1

1. Activities of people travelling to and staying in places ✓ outside of their usual environment for no more than one consecutive year ✓ for leisure, business and other purposes. ✓ It does not relate to any work done for money in the place visited. ✓ (4)

2.

<table>
<thead>
<tr>
<th>Inbound tourist</th>
<th>Tourists from other countries ✓ who stay for more than one day ✓ are inbound tourists (foreign tourists).</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outbound tourist</td>
<td>South African citizens travelling abroad ✓ have the same effect as imports on the balance of payments. ✓</td>
</tr>
</tbody>
</table>

(4)

3. Mapungubwe in Limpopo ✓ Vredefort Dome (meteorite) in North West ✓ Sterkfontein caves (Mrs Ples and Cradle of Humankind) ✓ Robben Island ✓ (any 3) (3)

4. Tourism requires economic infrastructure (roads), social infrastructure (ambulances) and basic services (clean water). ✓ This infrastructure needs to be maintained for local citizens, domestic and foreign tourists. ✓

Basic considerations for infrastructure development are:
- More infrastructure (e.g. water) ✓ ✓
- Upgrading (e.g. upgrade dirt roads to tarred roads) ✓ ✓
- New technology (e.g. transport) ✓ ✓ (8)

[19]
Activity 2

Choose the correct answer from the following alternatives:

Tourism is ________ intensive.
A. Labour
B. Capital
C. Risk

Answer to activity 2
A. Labour ✓✓

Activity 3

Choose the correct answer from the following alternatives:

Tourism benefits the household through________.
A. Lower incomes
B. Lower productivity
C. More infrastructure

Answer to activity 3
C. More infrastructure ✓✓
Below is a list of suggested past exam questions for extra practice:

- **Tourism problem (2 marks)** – February 2010, question 1.1.12
- **Tourist places (2 marks)** – February 2010, question 1.2.5
- **Spin-off benefit (2 marks)** – February 2010, question 1.3.3
- **World Heritage Site (2 marks)** – February 2010, question 5.1.3
- **Enterprises (6 marks)** – February 2010, question 5.2
- **Tourist numbers (10 marks)** – February 2010, question 5.3
- **Benefits (2 marks)** – February 2011, question 1.1.12
- **Ecotourism (2 marks)** – February 2011, question 5.1.1
- **Employment (2 marks)** – February 2011, question 5.1.4
- **Tourism (Soccer World Cup 10 marks)** – February 2011, question 5.3
- **Job creation (2 marks)** – November 2010, question 1.1.10
- **Development (2 marks)** – November 2010, question 1.2.5
- **Globalization (2 marks)** – November 2010, question 5.1.3
- **Positive impact (50 marks)** – November 2010, question 10
- **Tourism multiplier (2 marks)** – November 2011, question 1.1.11
- **Labour intensive (2 marks)** – November 2011, question 1.1.12
- **Visiting country (2 marks)** – November 2011, question 5.1.2
- **Examples of ecotourism (6 marks)** – November 2011, question 5.2
- **Importance of indigenous knowledge (8 marks)** – November 2011, question 5.5
- **Examples of tourism (8 marks)** – November 2011, question 5.6
- **Reasons for international growth (6 marks)** – November 2011, question 6.2

Keep going!
Environmental sustainability relates to the ability of the environment to survive its use for economic activity. The environment is not an unlimited resource and it is important that we sustain the environment so that it can be used by future generations.
14.1 Key concepts

These definitions will help you understand the meaning of key Economics concepts that are used in this study guide. Understand these concepts well. Use mobile notes to help you study them.

<table>
<thead>
<tr>
<th>Terms</th>
<th>Definitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Command and Control (CAC)</td>
<td>The direct regulation of an industry or activity through laws that state what is allowed and what is illegal</td>
</tr>
<tr>
<td>Conservation</td>
<td>Seeks creative continuity of the environment, while ensuring that environmental change considers the quality of life for both present and future generations</td>
</tr>
<tr>
<td>Environmental sustainability</td>
<td>The ability of the environment to survive its use for economic activity. It refers to meeting the needs of the present generation without compromising the needs of future generations.</td>
</tr>
<tr>
<td>Pollution</td>
<td>Emissions which flow into the natural environment from human activity, and which are beyond the capacity of the environment to absorb</td>
</tr>
<tr>
<td>Preservation</td>
<td>To keep resources that are non-renewable intact, e.g. ecological systems, heritage sites</td>
</tr>
<tr>
<td>The United Nations Conference on Environment and Development (UNCED)</td>
<td>UNCED was held in 1992 and is known as the Earth Summit. The goal of UNCED was to create strategies to stop and reverse the effects of environmental degradation (damage), and to support international efforts to promote sustainable development in all countries.</td>
</tr>
</tbody>
</table>

Use mobile notes to help you learn these key concepts. Learn more about mobile notes on page xii in the introduction.
14.2 The state of the environment

The state of the environment is very important for environmental sustainability. If the environment is damaged, it will become more difficult to sustain life on earth. The environment can be damaged by excessive (too much) mining; by farming without allowing the soil to recover; by excess fishing without allowing the fishing stocks to build up again; and by not controlling the release of pollution.

14.2.1. Pollution

Pollution relates to the introduction of contaminants (poisons) that damage the natural environment. Pollution can come from chemical substances released by factories, as well as from household and business waste and rubbish. Pollution policy is difficult to apply in practice. The following 3 concerns relate to pollution:

- **Technology and control**: New technology is cleaner and has less impact on the environment. The government controls pollution by limiting the use of older technologies that pollute the environment.
- **Marginal decisions**: These are decisions made by government on what acceptable levels of pollution are. If the government is too tolerant, or makes its decisions in the interest of expanding business rather than sustaining the environment, then pollution levels can rise to the point where they damage the environment.
- **Self-interest**: For example, keeping a beach litter-free. People use dustbins on the beach because they want to use a beach that is clean.

14.2.2. Conservation

Conservation relates to the preservation (looking after) of natural resources to ensure they are not completely used up and disappear from the environment. Conservation is necessary due to pollution and the over-utilisation (using too much) of resources:

The conservation of stocks (resources):

- Conservation is needed when stocks are utilised (used) more than they can reproduce to replace what has been used.
- This leads to a search for substitutes.
- Conservation policies help to conserve renewable stocks (e.g. trees) and non-renewable stocks (e.g. fossil fuels).

Maintaining renewable stocks:

- A market economy has an interest in conservation as it helps maintain renewable stocks, e.g. timber and fishing. Without conservation, timber factories and fisheries could be forced to close down.
- **Direct controls**: The government maintains the stock levels of environmental resources through the issuing of permits and quotas. For example, the government sets quotas for fishing to stop catches being so large that they exceed (are bigger than) the growth of the fish population. It also sets quotas for cutting down trees to ensure deforestation does not exceed the rate of renewal.
14.2.3. Preservation

Preservation is linked to conservation. It is about preserving existing assets to ensure they do not get used in a way that is destructive to the environment.

- **Private property**: A game reserve may be sold to a businessman to be used for farming. But the government can intervene and stop the sale because they recognise the importance to the environment of preserving game reserves.
- **Preservation requires compromise** (give and take): Farmers may develop their river mouth as a holiday resort. If this is not controlled, and too many other farmers do the same, the entire ecosystem will be damaged, and animal and plant life will be negatively affected.
- **Government policy**: Government intervenes to preserve environmental assets by:
  - Buying, confiscating, expropriating (taking ownership) or nationalising resources, e.g. indigenous forests.
  - Subsidising key resources, e.g. privately owned ecosystems.

14.2.4. Externalities

Externalities mean costs and benefits that were not planned for.

- The extra costs and benefits of externalities are not factored in when assessing the state of the environment.
- It is hard to work out where negative externalities, such as air pollution, arise from.
- It is also hard to work out where positive externalities, such as a decrease in pollution, come from. For example, it can be difficult to identify which factory has stopped polluting.
14.3 Measures to ensure sustainability

It is important for governments to take steps to ensure sustainability. Sometimes, businesses are driven by self-interest, and they see nothing wrong with using all available resources if they can make a profit from them. There are 5 controlling mechanisms to ensure sustainability:

14.3.1. The market

The market is driven by self-interest. The market considers the environment as an asset to be used for its own benefit. Sustainability is achieved in the free market only to the extent that resource prices rise as they become scarce (less available), and through the development of environment-friendly technology.

There is a social interest in using the environment, not only to the direct producer/consumer, but also to people in general, now and in the future. This means we all have an interest in preserving the environment.

Reasons why the market fails to ensure sustainability:

- The market sees the environment as a common resource.
- Externalities such as air pollution caused by factories cannot be stopped without restrictive policies.
- Lack of knowledge: Businesses cause damage without realising it, e.g. companies making aerosol cans (such as spray-on deodorants) did not know the damaging effect they had on the ozone layer.
- Carelessness: People continue with harmful practices and leave future generations to worry about the consequences.

Optimum market decisions

- Market mechanisms have failed when market forces fail to produce the desired result of environmental sustainability.
- All costs and benefits are not captured in the market price. The future cost of the resource disappearing is not often considered.

14.3.2. Public sector intervention

Public sector intervention aims to achieve social efficiency. This occurs through:

Granting property rights:

- The conservationist effect: People care for things that belong to them.
- To prevent fauna and flora species from becoming extinct, people are granted property rights if they agree to preserve the flora and fauna.
- Property rights can be expanded to common goods such as clean air.
- The Kyoto Protocol is an international agreement whereby developed countries pay developing countries for their right to pollute.

Charging for the use of the environment:

- Price the environment: The government levies fees for waste produced and dumped in the environment.
• In South Africa, local authorities levy charges on rubbish collection and sewage disposal.
• The best results are achieved when charges are proportional (related to) to waste produced.

Environmental taxes:
• Environmental taxes are taxes imposed on the output of goods that generate external environmental costs (pollution). These are called green taxes.
• Carbon dioxide emissions from wineries and vehicle tyres are taxed. The tax rate is equal to the marginal external cost.

Environmental subsidies:
• Subsidies are granted to businesses to reduce environmental damage, e.g. the government subsidises new technology that save energy, such as energy-saving light bulbs or solar geysers.

 Marketable permits:
• The government gives each business a licence to pollute to a certain degree.
• Businesses sell their licences to other businesses.
• In South Africa, marketable permits are granted by the Department of Minerals and Energy.

14.3.3. Public sector control
When government environmental policies don’t produce positive results, the government takes direct control through Command and Control (CAC) systems:

Command and Control (CAC):
• The government enforces policy by setting maximum levels of emission of pollution.
• Most developed countries have regulations that control air and water pollution.

There are 3 approaches in CAC systems:
• Quantity standards: These focus on the amount of pollution emitted.
• Quality standards: These focus on the environmental impact of the pollution emitted.
• Social impact standards: These focus on the effect on people of the pollution emitted.

Voluntary agreements:
• The government concludes agreements with businesses on a voluntary basis to cut pollution.

Education:
• Education is used to try to change people’s attitudes towards the environment.
• Innovative approaches have been tried in the developing world to educate people, e.g. setting up community wildlife reserves.
14.3.4. International measures

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

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

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

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

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

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

   - UNCED was known as the Earth Summit. It took place from 2 June to 14 June 1992.
   - The goal of UNCED was to come up with strategies to stop and reverse the effects of environmental degradation and to support international efforts to promote sustainable development in all countries.

2. Johannesburg – The World Summit on Sustainable Development (WSSD):
   - The WSSD was held from 26 August to 4 September 2002.
   - The WSSD’s goal was to halve world poverty by 2015.
   - The WSSD focused on marginalised groups, e.g. women and disabled persons.
Activity 1

Study the following sign and answer the questions that follow:

![Warning Chemical waste]

1. What environmental hazard is depicted in the above logo? (1)
2. Explain in your own words how the above can threaten the environment? (3)
3. Name an international protocol which addresses this hazard? (2)

Answers to activity 1

1. Chemical waste ✓ (1)
2. Pollution of water resources which can be very harmful to humans ✓ plants and animals ✓ (3)
3. The Stockholm Protocol ✓ ✓ (2)

[6]
Below is a list of suggested past exam questions for extra practice:

- **Indigenous knowledge (2 marks)** – February 2010, question 5.1.1
- **Pollution (2 marks)** – February 2010, question 5.1.2
- **Pollution (16 marks)** – February 2010, question 5.4
- **Pollution (2 marks)** – February 2011, question 1.1.10
- **Exhausted min. (2 marks)** – February 2010, question 1.2.5
- **Green taxes (2 marks)** – February 2010, question 1.3.7
- **Deforestation (2 marks)** – February 2010, question 5.1.2
- **Indigenous knowledge (6 marks)** – February 2010, question 5.2
- **Fuel levies (10 marks)** – February 2010, question 5.4
- **Protocols (8 marks)** – February 2010, question 5.6
- **Measures to ensure sustainability (50)** – February 2010, question 10
- **Pollution (2 marks)** – November 2010, question 1.1.12
- **Pollution (2 marks)** – November 2010, question 1.3.7
- **Environmental taxation (2 marks)** – November 2010, question 5.1.4
- **Tuna hunting (10 marks)** – November 2010, question 5.3
- **Renewable and non-renewable resources (8 marks)** – November 2010, question 5.5
- **Sustainability (2 marks)** – November 2011, question 1.2.5
- **Kyoto Protocol (2 marks)** – November 2011, question 1.3.7
- **Protection (2 marks)** – November 2011, question 1.3.8
- **Coral reefs (2 marks)** – November 2011, question 5.1.3
- **Renewable (2 marks)** – November 2011, question 5.1.4
- **Renewable resources (10 marks)** – November 2011, question 5.3
- **Renewable resource (2 marks)** – November 2011, question 6.1.4
- **Pollution (10 marks)** – November 2011, question 6.4
Appendix: Past Grade 12 exam paper

In this section you will find:

- Grade 12 National Economics exam paper from February/March 2012 (pages 152 – 160)
- Grade 12 National Economics marking memo from February/March 2012 (pages 172 – 184)

Use this exam paper and marking memorandum to help you prepare for your exams:

1. Answer the questions in the exam. Time yourself so you complete it within 3 hours (which is the time you will have in the real exam).
2. Treat each one as a ‘real’ exam by making sure you have all the materials you need (pens, pencils, eraser, protractor and calculator).
3. This exercise is meant to test your knowledge – so don’t cheat yourself by looking up the answers provided in the marking memoranda before you’ve finished each exam.
4. Use the memoranda to check whether or not your answers are correct. Note where you have got answers wrong – these are the sections of the curriculum that you need to do more work on. Go back to your textbooks and to the relevant sections of this study guide, and spend time learning the sections for which you got the lowest marks.
5. And remember: success depends on practise, practise, practise, and then more practice! Repeat this exercise as often as you can so that you fly in your year-end exams!
INSTRUCTIONS AND INFORMATION

1. Answer SIX questions as follows in the ANSWER BOOK:
   SECTION A: COMPULSORY
   SECTION B: Answer any THREE of the five questions.
   SECTION C: Answer any TWO of the four questions.

2. Write the question number above each answer.

3. Number the answers correctly according to the numbering system used in this question paper.

4. Read the questions carefully.

5. Start EACH question on a NEW page.

6. Leave 2–3 lines between subsections of questions.

7. Answer in full sentences and ensure that the format, content and context of your responses comply with the requirements of the questions.

8. Answer only the required number of questions. Answers in excess will NOT be marked.

9. Use only black or blue ink.

10. You may use a non-programmable pocket calculator.

11. Write neatly and legibly.
SECTION A (COMPULSORY)

QUESTION 1 50 MARKS – 25 MINUTES

1.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter (A–C) next to the question number (1.1.1–1.1.12) in the ANSWER BOOK.

1.1.1 Indicators which change before the business cycle changes are called … indicators.
A leading
B lagging
C coincident

1.1.2 The purchase of shares on the JSE by a foreigner is an example of … investments.
A indirect
B gilt-edged
C portfolio

1.1.3 The new economic paradigm is embedded in … side policies.
A demand-
B supply-
C demand- and supply-

1.1.4 To reduce cost without producing fewer goods, refers to …
A productive inefficiency.
B productive efficiency.
C opportunity cost.

1.1.5 In the case of merit goods, the market tends to … these goods.
A oversupply
B undersupply
C tax

1.1.6 A firm will increase production when …
A $MC = MR$
B $MR > MC$
C $P = MC$

1.1.7 Globalisation is increased by trade …
A liberalisation.
B restrictions.
C barriers.

1.1.8 To reap the benefits of efficient markets, countries rely on the principle of … advantage.
A comparative
B competitive
C relative

1.1.9 The policy which reflects the demographic and gender profile of the country is known as the … policy.
A Black Economic Empowerment
B land restitution
C affirmative action

1.1.10 A national demand for higher wages will lead to …
A demand-pull inflation.
B cost-push inflation.
C deflation.

1.1.11 Tourists are fascinated by local community practices, food preparation and rituals. This complex set of knowledge and skills is known as …
A indigenous knowledge systems.
B infrastructure development.
C the tourism product.

1.1.12 A firm will spend less on pollution reduction equipment because of its small marginal …
A private cost.
B social cost.
C private benefit. (12 x 2) (24)
1.2 Give ONE term for each of the following descriptions by choosing a term from the list below. Write only the term next to the question number (1.2.1–1.2.6) in the ANSWER BOOK.

<table>
<thead>
<tr>
<th>COLUMN A</th>
<th>COLUMN B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal policy</td>
<td>$1 = R7.40</td>
</tr>
<tr>
<td>SETA</td>
<td>government spending and taxation</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>workplace skills and leadership</td>
</tr>
<tr>
<td>Non-price competition</td>
<td>minimum earnings required to prevent the entrepreneur from leaving the industry</td>
</tr>
<tr>
<td>Normal profit</td>
<td></td>
</tr>
<tr>
<td>Ad valorem</td>
<td>the price level rises so rapidly that people lose confidence in the value of the currency of a country</td>
</tr>
<tr>
<td>Hyperinflation</td>
<td></td>
</tr>
<tr>
<td>Ecotourism</td>
<td>advertising campaigns</td>
</tr>
<tr>
<td></td>
<td>a tariff as a percentage of the value of imported goods</td>
</tr>
<tr>
<td></td>
<td>equal to economic profit</td>
</tr>
<tr>
<td></td>
<td>the enjoyment and appreciation of undisturbed nature</td>
</tr>
</tbody>
</table>

(5 x 2) (16)

TOTAL SECTION A: 50

SECTION B
Answer any THREE of the five questions from this section in the ANSWER BOOK.

QUESTION 2 50 MARKS – 25 MINUTES

2.1 Choose the correct word from those given in brackets. Write only the word next to the question number (2.1.1–2.1.4) in the ANSWER BOOK.

2.1.1 In the circular flow, savings is an example of a/an (leakage/injection).
2.1.2 Direct investments include investment in (antiques/fixed property).
2.1.3 The budget is presented to parliament by the Minister of (Finance/Public Enterprises).
2.1.4 Government intervention was condemned by the (Keynesians/Monetarists).

(4 x 2) (8)

2.2 List the THREE sectors that are used to calculate the gross value added at basic prices.

(3 x 2) (6)
2.3 Study the graph below and answer the questions that follow.

**Laffer Curve**

- **2.3.1** What is illustrated by the Laffer curve? (2)
- **2.3.2** At what point will government revenue maximise? (2)
- **2.3.3** What will be the effect on government revenue if the tax rate increases from 40% to 80%? (2)
- **2.3.4** What is the implication for the government if the taxpayer is taxed at 100%? (2)
- **2.3.5** What illegal behaviour by the worker will be encouraged if the tax rate is too high? (2)

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

**Business Cycle**

- **2.4.1** Name ONE turning point in the business cycle. (2)
- **2.4.2** What is indicated by the trend? (2)
- **2.4.3** Explain how the government can stimulate economic activity in an effort to smooth out business cycles. (4)
- **2.4.4** What impact, do you think, will a huge investment, such as the Gautrain project, have on the business cycle? (2)

2.5 Explain the role of the foreign sector as a participant in the circular flow. (4 x 2)

2.6 Discuss changes in exchange rates as a method to correct the balance of payments disequilibria. (4 x 2)
QUESTION 3

50 MARKS – 25 MINUTES

3.1 Choose the correct word from those given in brackets. Write only the word next to the question number (3.1.1–3.1.4) in the ANSWER BOOK.

3.1.1 Decisions without interference from the government, describe a/an (regulated/unregulated) market.

3.1.2 Costs which remain the same regardless of the level of production are called (fixed/variable) costs.

3.1.3 Pollution is a form of a (private/social) cost.

3.1.4 Eskom is an example of a (natural/artificial) monopoly. (4 x 2) (8)

3.2 List the THREE institutions that control anti-competitive behaviour in South Africa. (3 x 2) (6)

3.3 Study the graphs below and answer the questions that follow.

![Graphs showing industry and individual business price and quantity relationships.]

3.3.1 Which type of market structure is represented by the graphs? (2)

3.3.2 How is the price for an individual business determined? (2)

3.3.3 Copy the graph of the industry into your ANSWER BOOK and show what would happen to the price if most of the firms decide to leave this market. (8)

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

**COLLUSION IN A BOTTLE**

Europe enjoyed the benefit of cheap glass bottles, due to a very competitive market. However, prices of glass bottles sky-rocketed in the US and South Africa.

The glass bottle industry experienced a change in market structure. The shortage of glass bottles is keeping wine from getting to markets worldwide. It seems as if glass manufacturers like Consol and Nampak (SA) and Owens Illinois (US) is putting the squeeze on the wine industry. This may be an opportunity to go green and use refillable wine bottles – like in French supermarkets where you fill up your bottle from a stainless steel tank.

Local producers in South Africa are considering exporting wine in bulk or to import glass from Europe.

[Source: Adapted from Stormhoek.com, 29 July 2007]

3.4.1 Explain the concept collusion. (2)

3.4.2 Which characteristic of the oligopoly features clearly in the extract? Motivate your answer. (4)

3.4.3 How can government intervention resolve this shortage in the production of glass? (2)

3.4.4 How will the import of bottles from Europe affect local wine prices? (2)

3.5 Discuss how the provision of public goods and services can lead to market failure. (4 x 2) (8)

3.6 Draw a fully labelled graph to illustrate the shut-down point in a perfect market. (8)
QUESTION 4

50 MARKS – 25 MINUTES

4.1 Choose the correct word from those given in brackets. Write only the word next to the question number (4.1.1–4.1.4) in the ANSWER BOOK.

4.1.1 A budget deficit of less than (3%/10%) of the GDP is an acceptable benchmark in line with international best practice.

4.1.2 Economic growth consists of growth of real (per capita GDP)/GDP.

4.1.3 Export processing zones are (free-trade/protectionist) areas linked to a harbour or airport.

4.1.4 Loans to the public and private sector for infrastructure development are granted by the (SARB/DBSA). (4 x 2) (3)

4.2 Name any THREE macroeconomic policy objectives in South Africa. (3 x 2) (6)

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

Since 2001, more than 800 firms and 100 000 jobs have disappeared from the South African textile industry.

4.3.1 Explain the term dumping. (2)

4.3.2 What effect do cheap imports from China have on the textile industry of South Africa? (2)

4.3.3 Name ONE measure that the government can employ to reduce cheap Chinese imports. (2)

4.3.4 Give TWO reasons why investment from China does not really benefit Africa. (4)

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

ENERGISING REGIONAL ECONOMIC GROWTH

Load-shedding occurs when power systems are overloaded and power utilities disconnect part of the power supply system in an attempt to prevent the entire system failing. SADC are urging individuals and industries to save power, in an attempt to manage demand.

Inadequate investment into the generation and transmission of energy infrastructure over the past 20 years has also contributed to this situation.

The SADC Energy division's main objective is to ensure the availability of sufficient, least cost energy services that will assist in achieving economic efficiency and the eradication of poverty, whilst ensuring an environmentally sustainable use of energy resources.

[Source: Adapted from Skylaws: March 2011]

4.4.1 Give ONE reason why authorities use load-shedding. (2)

4.4.2 Name ONE member country of the South African Development Community (SADC). (2)

4.4.3 What is meant by energy infrastructure? (2)

4.4.4 Name TWO advantages for the government in using low-cost energy services. (4)

4.5 Discuss the Gini coefficient. (4 x 2) (8)

4.6 Explain Spatial Development Initiatives (SDIs). (4 x 2) (8)

[56]
QUESTION 5

5.1 Choose the correct word from those given in brackets. Write only the word next to the question number (5.1.1–5.1.4) in the ANSWER BOOK.

5.1.1 A combination of increasing unemployment and high inflation is known as (deflation/stagflation).

5.1.2 Inflation generally benefits (pensioners/debtors).

5.1.3 Domestic tourism refers to people travelling (outside/within) the borders of a country.

5.1.4 Meeting the needs of the present generation without compromising the needs of future generations is called (sustainable/urban) development.

5.2 Name any THREE causes of demand-pull inflation.

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

THE IMPACT OF NATURAL DISASTERS ON SUSTAINABILITY

Floods in central Europe, wildfires in Russia, widespread flooding in Pakistan, earthquakes and tsunamis hitting Japan, are weather-related natural catastrophes we are dealing with right now. Before the World Climate Summit in November 2010 in Cancun, Mexico, there appears to be a link between the increasing weather extremes and climate change.

In the last 30 years, there has been a sharp increase in loss, related to weather events. Total economic losses rose from $50 billion in 2009 to $130 billion in 2010.

A total of 950 natural disasters were recorded in 2010. 56 000 people died in the Russian heat wave and 220 000 from the Haiti earthquake.

[Source: Adapted from Associated Press, 4 January 2011]

5.3.1 Define the concept environmental sustainability.

5.3.2 Which international agreement is referred to in the extract?

5.3.3 What effect do the natural disasters above have on renewable resources?

5.3.4 How will earthquakes and tsunamis lead to water pollution?

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

5.4.1 Which institution plays a key role in controlling inflation?

5.4.2 What does the abbreviation MPC in the above cartoon stand for?

5.4.3 What rates are used to influence consumer spending?

5.4.4 What does 3–6% refer to?

5.4.5 Which policy is used by the government to control the money supply in South Africa?

5.5 Discuss any TWO fiscal measures that can be used to combat inflation.

5.6 Discuss any TWO public sector intervention measures to ensure environmental sustainability.
QUESTION 6

50 MARKS – 25 MINUTES

6.1 Choose the correct word from those given in brackets. Write only the word next to the question number (6.1.1–6.1.4) in the ANSWER BOOK.

6.1.1 The (HDI/RDP) focuses on living a long and healthy life, being educated and having a decent standard of living. (2)

6.1.2 Economies that have developed and developing components are known as (industrialised/dualistic) economies. (2)

6.1.3 Price discrimination occurs when (identical/different) goods are sold at different prices. (2)

6.1.4 A cost-benefit analysis is normally done for projects in the (public/private) sector. (4)

6.2 Give any THREE examples of social indicators used in South Africa. (3)

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

MANUFACTURING

The manufacturing sector focuses on stimulating the growth of activities, such as services, job creation and economic empowerment.

Primary aspects of the Integrated Manufacturing Strategy (IMS) involve:

• Improving market access for South African products in key growth sectors
• Finding ways to harness skills and expertise in South Africa so that they can be sold to other countries

The IMS also promotes BEE and small-business development.

[Source: Adapted from Yearbook 2009/2010]

6.3.1 Define the manufacturing sector. (2)

6.3.2 Why, do you think, the promotion of small-business development is important to the IMS? (2)

6.3.3 Give ONE example of a key growth sector. (2)

6.3.4 Why, do you think, the Integrated Manufacturing Strategy promotes BEE? (4)

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

6.4.1 Define the term externality. (2)

6.4.2 Which type of externality is depicted by this graph? (2)

6.4.3 At which output level is production taking place on the market? (2)

6.4.4 Explain how this externality leads to market failure. (4)

6.5 Draw a comparison between economic growth and economic development. (2)

6.6 Explain how government intervention can improve income distribution when markets fail. (4)

TOTAL SECTION B: 150
SECTION C

Answer any TWO questions from this section in the ANSWER BOOK.

Essay responses:

- Responses should include an introduction, body and conclusion.
- For the introduction and conclusion 5 marks will be allocated.
- In addition, 5 marks will be allocated for the interpretation of the topic.
- A maximum of 40 marks will be allocated for the body.

QUESTION 7 50 MARKS – 40 MINUTES

Discuss the problems of public sector provisioning.

QUESTION 8 50 MARKS – 40 MINUTES

Discuss monopoly as a market structure and illustrate, with the aid of a graph, how a monopolist can achieve economic profit.

QUESTION 9 50 MARKS – 40 MINUTES

Discuss export promotion as part of South Africa’s foreign trade policy.

QUESTION 10 50 MARKS – 40 MINUTES

Discuss the benefits of tourism to the different sectors in the South African economy.

TOTAL SECTION C: 100
GRAND TOTAL: 300
SECTION A (COMPULSORY)

QUESTION 1: LO1–LO4

1.1 1.1.1 A – leading ✓ ✓
     1.1.2 C – portfolio ✓ ✓
     1.1.3 C – demand- and supply- ✓ ✓
     1.1.4 B – productive inefficiency ✓ ✓
     1.1.5 B – undersupply ✓ ✓
     1.1.6 B – MR > MC ✓ ✓
     1.1.7 A – liberalisation ✓ ✓
     1.1.8 A – comparative ✓ ✓
     1.1.9 C – affirmative action ✓ ✓
     1.1.10 B – cost-push inflation ✓ ✓
     1.1.11 A – indigenous knowledge systems ✓ ✓
     1.1.12 C – private benefit ✓ ✓

1.2 1.2.1 Open-market transactions ✓ ✓
     1.2.2 Terms of trade ✓ ✓
     1.2.3 AsgI-SA ✓ ✓
     1.2.4 Monopolistic competition ✓ ✓
     1.2.5 Kyoto Protocol ✓ ✓

1.3 1.3.1 B – government spending and taxation ✓ ✓
     1.3.2 C – workplace skills and leadership ✓ ✓
     1.3.3 A – $1 = R7.40 ✓ ✓
     1.3.4 F – advertising campaigns ✓
     1.3.5 D – minimum earnings required to prevent the entrepreneur from leaving the industry ✓ ✓
     1.3.6 G – a tariff as a percentage of the value of imported goods ✓ ✓
     1.3.7 E – the price level rises so rapidly that people lose confidence in the value of the currency of a country ✓ ✓
     1.3.8 I – the enjoyment and appreciation of undisturbed nature ✓ ✓

TOTAL SECTION A:   50

This memorandum consists of 22 pages.
SECTION B

QUESTION 2: LOI AS1-AS4 - MACROECONOMICS

2.1 2.1.1 leakage ✓✓
2.1.2 fixed property ✓✓
2.1.3 Finance ✓✓
2.1.4 Monetarists ✓✓

2.2
• Primary sector ✓✓
• Secondary sector ✓✓
• Tertiary sector ✓✓

2.3 2.3.1 Shows the relation between tax rates and tax revenue of the government ✓✓
2.3.2 At point V ✓✓
2.3.3 Tax revenue will decrease ✓✓
2.3.4 At 100% tax rate, nobody will be prepared to work and the revenue of government will also be zero ✓✓
2.3.5 Tax evasion may occur ✓✓

2.4 2.4.1 Point B (peak)/D (trough) ✓✓

2.4.2 It indicates the expected growth rate of a country ✓✓ Also referred to as the long-term growth potential of the economy ✓✓ the general direction in which the indexes that were used in business cycles move ✓✓

2.4.3 • Using expansionary monetary policies ✓✓ e.g. reducing interest rates ✓✓
• Expansionary fiscal policies ✓✓ e.g. reducing tax ✓✓
• Increased government expenditure ✓✓ e.g. capital investment projects

(Any other relevant examples)

2.4.4 If the business cycle is currently in a downswing, it will lead to the turning point, moving into an upswing ✓✓ If the business cycle is currently in an upswing, it will lead to an extended expansion phase ✓✓

(Any other relevant answer)

2.5
• There is a flow of goods (imports) to the business from the foreign sector ✓✓
• which the business pays for ✓✓
• This will be regarded as expenditure for the business ✓✓
• There is also a flow of goods from the business to the foreign sector ✓✓
• This will be income for the business ✓✓

(Any 4 x 2) (8)

2.6
• Free-floating exchange rates: They work automatically. If imports increase, the demand for foreign exchange increases. The currency depreciates as a result of working of market forces. Depreciation makes imports more expensive in the depreciating country and exports cheaper in the foreign country. Imports decrease and exports increase, and the currency appreciates.
• Managed floating exchange rates: Central banks use their reserves to effect depreciation and appreciation. Over the long term currencies have to find their equilibrium levels.
• Fixed exchange rates: Currencies are devalued and revalued. (Any 4 x 2) (8) [80]
QUESTION 3: LO2 AS1–AS3 – MICROECONOMICS

3.1 3.1.1 unregulated ✓✓

3.1.2 fixed ✓✓

3.1.3 social ✓✓

3.1.4 artificial ✓✓ (4 x 2) (8)

3.2 • Competition Commission ✓✓

• Competition Tribunal ✓✓

• Competition Appeal Court ✓✓ (3 x 2) (6)

3.3 3.3.1 Perfect market ✓✓

3.3.2 Market demand and supply establishes the price in the market (R8) ✓✓

The individual producer on the market is a price taker ✓✓ and will sell any quantity at the price of R8.

3.3.3

3.4 3.4.1 Collusion is an arrangement between businesses with the aim to limit competition between them ✓✓

3.4.2 • Type of product ✓✓ wine is a differentiated product ✓✓

• Market entry ✓✓ although it is free, it is not easy ✓✓

• Control over prices ✓✓ Consol and Nampak has considerable control over prices, but not as much as Owens Illinois as monopolist ✓✓

• Mutual dependence ✓✓ one business is influenced by the other businesses’ action ✓✓

(Any 1 x 4) (4)

3.4.3 Through the competition policy the government can:

• Prevent the abuse of economic power ✓✓

• The growth of market power ✓✓

• Prevent restrictive practices ✓✓ (Any 1 x 2) (2)

3.4.4 Positive effect on local wine prices (decrease) cetera par. ✓✓

(2)

3.5 • If the provision of public goods were left to the market we would not have any public goods ✓✓

• The provision of public goods and services requires a huge capital outlay ✓✓ and the return on investment in provision of public goods is not profitable ✓✓

• The failure to supply public goods means we would be less well-off ✓✓

• There would be allocative inefficiency ✓✓

• The reason why the market fails to supply these goods is because:

- public goods are non-excludable ✓✓

- public goods are non-rival ✓✓ (Any 4 x 2) (8)

3.6 Fully labelled graph to illustrate shut-down point in a perfect market

(8)

[Graph]

Please turn over
QUESTION 4: LO3 AS1–AS4 – ECONOMIC PURSUITS

4.1 3% ✓✓
4.1.2 GDP ✓✓
4.1.3 free-trade ✓✓
4.1.4 DBSA ✓✓
        (4 x 2)  (8)

4.2 • Economic growth ✓✓
• Full employment ✓✓
• Price stability ✓✓
• Balance of payments stability ✓✓
• Equitable distribution of income ✓✓
        (Any 3 x 2)  (6)

4.3 4.3.1 Dumping occurs when goods are sold to foreign markets at such low prices that the local industries cannot compete ✓✓
        (Any other relevant answer)  (2)
4.3.2 A large number of firms are forced to close down ✓✓ / Textile workers are becoming unemployed ✓✓
        (Any 1 x 2)  (2)
4.3.3 Grant protection ✓✓ /
E.g. quotas, tariffs, customs duties, subsidies ✓✓
        (Any 1 x 2)  (2)
4.3.4 Investment is in the extraction of raw materials ✓✓ rather than in the manufacturing of goods and services that would increase the GDP ✓✓/the low value of raw materials does not contribute to the industrial development of the economy ✓✓
        (Any 2 x 2)  (4)

4.4 4.4.1 To prevent the entire system from failing ✓✓
Any other alternatives e.g. energy savings  (2)
4.4.2 Angola/Botswana/Democratic Republic of Congo/Lesotho/
Madagascar/Malawi/Mauritius/Mozambique/Rwanda/Seychelles/
South Africa/Swaziland/Tanzania/Zambia/Zimbabwe ✓✓
        (Any 1 x 2)  (2)
4.4.3 Supporting structures to the production processes ✓✓
(e.g.) transmission corridors, power stations, hydro power stations,
pylons ✓✓
        (Any 1 x 2)  (2)
4.4.4 • Attaining economic efficiency ✓✓
• Eradication of poverty ✓✓
• Ensuring a environmentally sustainable use of resources ✓✓
        (Any 2 x 2)  (4)

4.5 • Calculated from using the information provided by the Lorenz curve ✓✓
• Shows the distribution of income among proportions of the population ✓✓
• Is the ratio of the proportion of the population who lives on less than a proportional income ✓✓
• Measures the degree of inequality in incomes ✓✓
• If income is perfectly distributed the co-efficient is 0 ✓✓
• At the other extreme the co-efficient would be 1 ✓✓
• A government should try to address the unequal distribution of incomes in a country by using tools such as the progressive tax scale ✓✓ and by creating opportunities to create higher incomes ✓✓ through BEE ✓✓ and employment equity ✓✓
        (Any 4 x 2)  (8)

4.6 • South Africa's SDI programme is aimed at attracting infrastructure ✓✓ and investments to neglected and underdeveloped areas ✓✓
• It endeavours to foster sustainable industrial development and growth ✓✓ particularly in areas where poverty and unemployment are at their highest ✓✓
• SDIs enable government to enforce its industrial development commitment across national, provincial and local government boundaries ✓✓
• The SDI is an interdepartmental investment strategy led by the national departments of Trade and Industry and Transport ✓✓
• Some SDIs are in the form of corridors ✓✓
• A corridor is a track of land that forms a passageway allowing access from one area to another and offering particular advantages to mining, manufacturing and other businesses ✓✓
• (e.g.) Maputo Corridor, Coast-to-Coast corridor ✓✓
        (Any 4 x 2)  (8)

QUESTION 5: LO4 AS1–AS4 – CONTEMPORARY ECONOMIC ISSUES

5.1 5.1.1 stagflation ✓✓
5.1.2 debtors ✓✓
5.1.3 within ✓✓
5.1.4 sustainable ✓✓
        (4 x 2)  (8)
5.2 • Increase in disposable incomes of households/consumption/general public not savings conscious ✓✓
• Easy availability of credit ✓✓
• Increase in economically active population ✓✓
• Increase in money supply without corresponding increase in production ✓✓
• Excessive demands/commodities demand ✓✓
• Investment spending/not enough savings to finance essential capital investments ✓✓
• Government spending increases ✓✓
• Government’s spending becomes extravagant ✓✓
• Export earnings increase ✓✓
• Working of market mechanism ✓ (Any 3 x 2) (6)

5.3 5.3.1 Environmental sustainability means the ability of the environment to survive its use for economic activity ✓✓ (2)
5.3.2 World Climate Summits/Cancun Summit in Mexico ✓✓ (2)
5.3.3 Natural disasters limit their availability due to the rate at which they can be produced ✓✓ (2)
5.3.4 Earthquakes cause water pipes to burst leading to water shortage ✓✓
    Tsunamis destroy fresh water resources/pollute fresh water/cause widespread flooding ✓✓ (4)

5.4 5.4.1 South African Reserve Bank ✓✓ (2)
5.4.2 Monetary Policy Committee ✓✓ (2)
5.4.3 Interest rates ✓✓ (2)
5.4.4 Inflation target ✓✓ (2)
5.4.5 Monetary policy ✓✓ (2)

5.5 • Increased direct taxation ✓✓ reduce excessive demand in the economy ✓✓
• Increased indirect taxation ✓✓ e.g. VAT and excise duties ✓✓
• Reducing government spending ✓✓ cancel government projects ✓✓
• Introduce measures like tax rebates to improve productivity ✓✓
• Loan levy can be introduced ✓✓
• Finance budget deficit on non-inflationary basis ✓✓ get loans from non-banking sector ✓✓
• Imposing surcharge on imported goods ✓✓ increases prices of imported goods – consumers buy fewer goods ✓✓
• Supply-side economy ✓✓ reducing tax on personal income, company tax, tax on interest and dividends and government spending ✓✓ (Any 2 x 4) (8)

6.6 • Granting property rights ✓✓ ensures that people cares for things that belong to them by using them as profitable as possible ✓✓ if property rights are expanded to common goods, polluters can be charged for the right to pollute ✓✓
• Charging for the use of the environment ✓✓ impose environmental charges – levies fee on consumers and producers for waste they produce and dump in environment ✓✓
• Environmental taxes ✓✓ taxes imposed on output of good e.g. taxes charged on items such as tyres will increase the price of tyres ✓✓
• Environmental subsidies ✓✓ for activities that reduce environmental damage – cost to reduce or prevent harmful effects is recovered from proceeds of taxation ✓✓ used for development of new techniques or equipment ✓✓ encourage production of environment friendly substitutes ✓✓ encourage recycling of waste ✓✓
• Marketable permits ✓✓ businesses are allowed to pollute by giving them a licence to pollute up to a maximum – these licences can be sold to other businesses if they do not pollute at all ✓✓ (Any 2 x 4) [50]

QUESTION 6: LO2 & LO3 AS1–AS4 – MICROECONOMICS AND ECONOMIC PURSUITS

6.1 6.1.1 HDI ✓✓
6.1.2 Industrialised ✓✓
6.1.3 Identical ✓✓
6.1.4 Public ✓✓ (4 x 2) (8)

6.2 • Health and nutrition ✓✓
• Education ✓✓
• Services ✓✓
• Housing and urbanisation ✓✓ (Any 3 x 2) (5)

6.3 6.3.1 Manufacturing sector is concerned with the transformation of raw materials into semi-finished or finished goods ✓✓ (2)
6.3.2 More jobs can be created/increased competition in the market benefits the consumer (lower prices) ✓✓ (Any other relevant fact) (2)
6.3.3 • Exports ✓✓
• Tourism ✓✓
• Agriculture ✓✓
• Information, communication and technology ✓✓
• Cultural industries ✓✓ (Any 1 x 2) (2)
6.3.4 It promotes BEE because it complies with transforming the South African economy so that the number of black people that own and manage and control the economy can increase significantly and income inequalities will decrease substantially (Any other relevant answer) (2 x 2) (4)

6.4
6.4.1 Occurs when some of the costs and benefits of a decision or action are borne or enjoyed by a second or third party not directly involved in the decision making (Any other relevant answer) (2)

6.4.2 Negative (2)

6.4.3 At quantity Q1 (2)

6.4.4 The cost of the externality is not included in the market price therefore there is a misallocation of resources if the cost of externality was taken into account, then the market would produce at Q2 which is more desirable to society (Any 2 x 2) (4)

6.5 • Economic growth is defined as an increase in the real value of production and income in a country
• Economic growth occurs as a result of an increase in the productivity of a country and is reflected by an increase in the value of real gross domestic product (GDP)
• Economic development can be defined as structural changes in the economy that can lead to an increase in the standard of living and an increase in the level of economic welfare of the poor
• Economic development would result in a more equitable distribution of wealth and income, better access to health care and education of the poor (Any other relevant answer) (2 x 4) (8)

6.6 • Through its taxing (Progressive Tax System) and spending powers (Budget) the government can distribute income by subsidising goods and services
• Transferring income to poorer households (e.g.) grants
• Providing certain goods free of charge
• Implementing job creation programmes
• Implementation of minimum wages for the unskilled worker
• Setting of maximum prices on basic foodstuffs (paraffin) which benefit the poor
• Policy measures (e.g.) Land Reform programmes /BEE\ Affirmative Action (Employment Equity Act), Property subsidies
• Preferential access to government contracts for the previously disadvantaged (Any 4 x 2) (8)

[50]

TOTAL SECTION B: 150

SECTION C

Answer any TWO questions from this section in the ANSWER BOOK.

Essay responses:
• Responses should include an introduction, body and conclusion.
• For the introduction and conclusion 5 marks will be allocated.
• In addition, 5 marks will be allocated for the interpretation of the topic.
• A maximum of 40 marks will be allocated for the body.

QUESTION 7: LO1 AS3 – MACROECONOMICS

Discuss the problems of public sector provisioning.

INTRODUCTION

The government responds to market failures by establishing and maintaining state-owned enterprises to provide public goods and services (Max. 3)

BODY

1. Accountability
• It is required to give an explanation of one’s decisions, actions and expenditures over a period of time
• There are mechanisms for evaluating government’s economic and financial performance
• That the desired quantities and quantity of goods and services for which taxes are raised are delivered
• That monopolies, corruption, nepotism, incompetence and apathy does not occur
• Two important elements of accountability is participation and transparency
• Ministerial responsibilities i.e. the ministers of government departments are responsible for decisions and actions and expenditures
• Parliamentary questioning arises and members of the government departments have to respond
• The national treasury is responsible for treasury control
• The Auditor-General reports annually in writing on each government department

[50]
2. Efficiency
- Public goods are efficiently provided if Pareto efficiency is achieved.
- That is if resources are allocated in such a way that no one can be made better off without making someone else worse off.
- Bureaucracy: the official rules and procedures, insensitivity to the needs of their clients.
- Ineffectiveness: the lack of skills or ability to do a task successfully.
- May have improper qualifications or an attitude of apathy.
- Corruption: the exploitation of a person's position for private gain, taking bribes, committing fraud, nepotism.

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

4. Pricing policy
- In a market economy, prices are determined by supply and demand.
- The objectives of firms are to maximize their profits and they usually set prices to achieve this objective.
- Government is not set confined to the profit maximization objective.
- Government takes into account certain social, economic, political, and environmental conditions as well as public opinion.
- Free-of-charge services: this is met from taxes and applies to most community goods (e.g., defence, police and collective goods) whereby charges and toll fees are levied.
- User-charges: option to charge depends on technical reasons (e.g., cost of providing a double lane road could be recovered by toll charges).
- Economic reasons such as services like water and electricity that have a zero price (e.g., political reasons where income distribution is significantly unequal, administrative rationing according to need takes place (e.g., public health and education).
- Direct and indirect subsidies: direct subsidies are used to cover part of the costs (e.g., urban bus service) and an indirect subsidy is used to write off accumulated losses or deficits.
- Standing charges: called availability charges (e.g., water and electricity) standing charges go to meet fixed costs and the price per unit consumed covers variable costs.

- Price discrimination: different users have different elasticities of demand for a good (e.g., commercial and manufacturing businesses pay higher rates than households and they pay on a sliding scale).

5. Parastatals: state-owned enterprises that either render a service or when an existing enterprise is nationalised. They focus on making a profit and maximizing cost at the expense of the needs of some groups (e.g., Iscor, SABC, SAA, Spoornet).

6. Privatisation refers to the process whereby state-owned enterprises and state-owned assets are handed over or sold to private individuals. Nationalisation is the process whereby the state takes control and ownership of privately owned assets and state enterprises. It includes contracting of services, Public-Private Partnerships, deregulation, increasing competitiveness.

(A) (5 x 8)

CONCLUSION
If the above problems are not dealt with timeously by government, government will continue to fail its people in terms of service delivery.
(Max. 2)

Any other relevant conclusion

Use the following assessment grid in conjunction with the above to assess the discussion:

<table>
<thead>
<tr>
<th>MARKS</th>
<th>INTERPRETATION OF TOPIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Candidate has shown no understanding of the topic.</td>
</tr>
<tr>
<td>1</td>
<td>Candidate has shown some understanding of topic but has missed important aspects of topic.</td>
</tr>
<tr>
<td>2</td>
<td>Candidate has interpreted topic correctly but has not linked facts to topic.</td>
</tr>
<tr>
<td>3</td>
<td>Candidate has interpreted topic correctly and has linked facts to topic.</td>
</tr>
<tr>
<td>4</td>
<td>[50]</td>
</tr>
</tbody>
</table>

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QUESTION 8: LO2 AS3 – MICROECONOMICS

Discuss monopoly as a market structure and illustrate, with the aid of a graph, how a monopolist can achieve economic profit.

INTRODUCTION

Is a market structure in which there is only ONE seller of a good or service that has no close substitutes (Max. 3)

BODY

MONOPOLY AS MARKET STRUCTURE

1. Number of firms
   - The monopoly consists out of one single firm
   - Example: Eskom or De Beers – diamond-selling
     (Accept any other relevant example)

2. Nature of product
   - The product is unique with no close substitute
   - Example: Diamonds are unique

3. Market entry
   - Refers to how easy or difficult it is for businesses to enter or to leave the market
   - Is entirely/completely blocked
   - A number of barriers to entry that may give rise to monopoly can be: economies of scale or limited size of the market or exclusive ownership of raw materials or patents or licensing or sole rights or import restrictions

4. Market Information
   - For a monopolist all information on market conditions is available to both buyers and sellers
   - This means that there are no uncertainties

5. Control over price
   - Regarded as a price maker
   - Able to influence price through changing the quantity but limited by market demand and the goal of profit maximisation
   - Monopolist chooses the combination of price and quantity that suits it the best

6. Demand curve for the firm’s product
   - It equals the market (industry) demand curve since it is responsible for the entire output of the industry
   - Downward-sloping from left to right

7. Marginal revenue curve
   - Because the demand curve is downward sloping price will decrease for each additional unit produced
   - Therefore the marginal revenue will be less than price, thus the demand curve and marginal revenue curve is not the same
   - The marginal revenue curve lies below the demand curve

8. Cost of production
   - The shape of the cost curves (MC and AC) is the same as any other producer
   - The MC increases as more is produced
   - The AC declines, reaches a minimum and then increases
   - Profit maximisation is where MC = MR

9. Profit
   - Can earn economic profit in the short run and the long-run
   - Because new entries are blocked (no competition) and short-run economic profit therefore cannot be reduced by new competing firms entering the industry
   - The monopoly can thus continue to earn economic profit as long as the demand for its product remains intact

(Max. 30)

Graph to illustrate economic profit for a monopolist

![Graph showing demand, marginal revenue, marginal cost, and economic profit]

Labeling of axes = 2 marks
Shape of cost curves = 2 marks
Shape of revenue curves = 2 marks
Profit maximising point = 1 mark
Indicating economic profit = 3 marks

TOTAL = 10 MARKS
CONCLUSION

In the short run, a monopolist can make an economic profit or an economic loss. They produce less output than competitive industries and sells at a higher price. ✔ ✔
(Any other relevant conclusion must be accepted.) (Max. 2)

Use the following assessment grid in conjunction with the above to assess the discussion:

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(Max. 5) [50]

QUESTION 5: LO3 AS3 – ECONOMIC PURSUITS

Discuss export promotion as part of South Africa’s foreign trade policy.

INTRODUCTION

Export promotion refers to measures taken by governments to increase production of goods and services that can be exported. The government provides incentives to encourage production ✔ ✔ ✔
(Max. 3)

BODY

REASONS

• Export promotion measures lower cost of production which make it easier to compete on the international market ✔ ✔
• Achieve significant export-led economic growth ✔ ✔
• Export enlarges production capacity of country because more and larger manufacturing industries are established ✔
• The first step to export-led economic growth is to implement policies that encourage the establishment of industries to produce goods and services for export markets ✔ ✔

METHODS

Exports are promoted through:
• Incentives ✔ ✔ export incentives include information on export markets, research with regard to new markets, concessions on transport charges, export credit and export credit guarantees and publicity commending successful exporters ✔ ✔ this will encourage manufacturers to export an increased volume of their production ✔ ✔ Trade missions help to market SA products abroad ✔ ✔ and supply SA companies with information about potential markets ✔ ✔
• Direct Subsidies ✔ ✔ described as direct because it involves government expenditure. Include cash payments to exporters, refunds on import tariffs and employment subsidies. The aim is to increase the competitiveness of exporting company ✔ ✔ reduce cost of production ✔ ✔ and explore and establish oversees markets ✔ ✔
• Indirect subsidies ✔ ✔ Regarded as indirect because it results in the government receiving less revenue ✔ ✔ e.g. general tax rebates, tax concessions on profits earned from exports or on capital invested to produce export goods, refunding of certain taxes e.g. custom duties on imported goods used in the manufacturing process ✔ ✔ allows companies to lower their prices and enables them to compete in international markets ✔ ✔
Challenge for governments to design incentives and subsidies in such a way that prices of export goods can't be viewed as dumping prices.

1) Trade neutrality can be achieved if incentives in favour of export production are introduced up to that neutralises the impact of protectionist measures in place; e.g. subsidies equal to magnitude of import duties can be paid.

2) Export processing zones (EPZs) is free-trade enclave within a protected area – is fenced and controlled industrial park that falls outside domestic customs area, and usually located near harbour or airport.

NOTE: For the response with regard to the effectiveness of export promotion methods, a maximum of 5 marks can be allocated.

ADVANTAGES

- No limitations on size and scale since world market is very large.
- Cost and efficiency of production based on this and organised along lines of comparative advantage.
- Increased domestic production will expand exports to permit more imports and may result in backward linkage effects that stimulate domestic production in related industries.
- Exchange rates are realistic and there is no need for exchange control and quantitative restrictions.
- Value can be added to natural resources of the country.
- Creates employment opportunities.
- Increase in exports has positive effect on balance of payments.
- Increase in production leads to lower domestic prices, which benefit local consumers.

DISADVANTAGES

- Real cost of production subsidies and incentives reduce total cost of production which must be met from sales; real cost is thus concealed by subsidies; products cannot compete in open market.
- Lack of competition businesses charge prices that are so low that they force competitors out of the market.

Increased tariffs and quotas can be against spirit of provisions of WTO. Overseas competitors retaliate with tariffs and quotas; goods are sold domestically below their real cost of production (export subsidies and dumping).

Protection of labour-intensive industries developed countries maintain high levels of effective protection for their industries that produce labour-intensive goods in which developing countries already have or can achieve comparative advantage.

Withdrawal of incentives often leads to closure of affected companies.

Incentives often lead to inefficiencies in the production process, since companies don't have to do their best to compete.

Can be seen as dumping (Max. 40)

CONCLUSION

The South African government has mandated Trade and Investment South Africa (TISA). From the above discussion it is clear that protection still plays a significant role in the South African international trade policy. (Any other relevant conclusion must be accepted.) (Max. 2)

Use the following assessment grid in conjunction with the above to assess the discussion:

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[56]
QUESTION 10: LO4 AS2 – CONTEMPORARY ECONOMIC ISSUES

Discuss the benefits of tourism to the different sectors in the South African economy.

INTRODUCTION

Tourism describes the activities of people traveling to and staying in places outside their usual environment for no more than one consecutive year for leisure, business and other purposes. (Max. 3)

BODY

1. BENEFITS OF TOURISM TO THE DIFFERENT SECTORS IN THE ECONOMY:

1.1 Households

- They receive income because of salaries and wages through employment and their own involvement in the tourism industry as tour operators.
- Most of the infrastructure that is created for tourists are also used by the local people e.g. roads, hotels.
- Tourism requires a number of skills, which require education and training.
- Learnerships for a number of skills required by the tourism industry are offered e.g. tour guides, travel agents and chefs.

1.2 Government

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

1.3 Businesses

- Economic and basic services infrastructure is usually provided by the public sector.
- A superstructure consists of businesses that provide accommodation, transport, and retailing and recreation services.
- Tourism also stimulates certain socio-economic objectives such as entrepreneurship development, Black Economic Empowerment and SMME development.

- They are normally private sector activities and make up the profit-generating element of a tourist destination.
- A combination of public and private sector finance is used to develop destinations.
- The public sector also provides a range of financial incentives for private sector tourism investment (grants, subsidies, loans, taxes).
- There are also many informal and less traditional opportunities for tourism benefits and these serve as stepping stones for previously neglected groups in the tourism business.
- E.g. car rentals, craft curios sales.

1.4 Infrastructure

- Adequate and well-maintained physical and basic services infrastructure are essential for tourist destination areas.
- Economic infrastructure has been prioritised by Department of Tourism.
- E.g. access to beaches, lakes and rivers.
- Social infrastructure has also been improved.
- E.g. ambulance services, medicines, and information services. (Max. 40)

CONCLUSION

From the above discussion it is clear how households, businesses, the government and infrastructure benefit from increased tourism. (Max. 2)

Use the following assessment grid in conjunction with the above to assess the discussion:

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(Max. 5) [50]

TOTAL SECTION C: 100
GRAND TOTAL: 300
The Mind the Gap study guide series assists you to make the leap by studying hard to achieve success in the Grade 12 exam.

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