 Province of the

EASTERN CAPE

EDUCATION

ECONOMICS

REVISION MATERIAL

2020

CONTEMPORARY ECONOMIC ISSUES

**CONTEMPORARY ECONOMIC ISSUES**

**INFLATION**

* Inflation
* Description: A sustained and **significant increase** in the **general price** level over a period of time; and a simultaneous decline in the buying power of money.
* Ways to measure inflation
  + **Indexes** - two indexes are used **Consumer Price Index (CPI)** and **Producer Price Index (PPI).**A price index is compiled by using the prices of a representative range of goods and services which are recorded on a regular basis.
  + **Weighting** – Each item in the basket of goods and services is given a weight. This weighted index reflects the importance of an item in the basket. The higher the weight the more important is the item.
  + **Inflation rate**: The inflation rate is determined by using changes in the CPI and/or PPI index. The figures for each month are compared to the corresponding month in the previous year
* **Types of inflation**
* **Consumer inflation**:

- ***Headline inflation***- unadjusted CPI rate; (is measured by CPI); consists of a shopping basket of goods and services of an ordinary South African household in urban areas.

It is used for inflation targeting, meaning when it is above 6% SARB may increase interest rates.

- ***Core inflation***- excludes item in the CPI basket that have **volatile prices** (continually changing) and those affected by government intervention. Examples vegetables; fresh and frozen meat and fish; interest rate on mortgage bonds; VAT and assessment rates.

Core inflation is lower than headline inflation and is often stable.

- ***Administered prices***- prices that are controlled by the government through authorities. e.g. electricity (NERSA),

* **Producer inflation**: Producer price index (PPI) measures prices of domestically produced goods.

Difference between Consumer Price Index and Producer Price Index

|  |  |
| --- | --- |
| **Consumer Price Index** | **Producer Price Index** |
| Pertains to cost of living | Pertains to cost of production |
| Basket consists of consumer goods and services | Basket consists of goods only |
| Capital and intermediate goods are excluded | Capital and intermediate goods are included |
| Prices include VAT | Prices exclude VAT. |
| Interest rates are taken into account | Interest rates are excluded. |
| Prices of imported goods are not shown | Prices of imported goods are shown explicitly |

* **All inclusive inflation**
* Economists check what happened to prices of all final goods and services produced in a particular year.
* Use the calculated implicit GDP deflator.
* GDP figures at current and constant prices are used as published in the national accounts.
* GDP at constant prices measures economic growth and measures inflation.
* Measures the inflation rate for economy as a whole.
* Implicit GDP deflator is the ratio of GDP at current prices to GDP at constant prices.
* To determine inflation: GDP deflator for next year X 100

GDP deflator for previous year

* **Hyperinflation**
* Very high rate of inflation (more than 50%).
* Price levels rise so rapidly that people lose confidence in the value of money.
* Becomes difficult for the economy to operate.
* People resort to goods as medium of exchange – barter system
* Can be solved by changing the country’s currency
* **Stagflation**
* A low growth rate, high unemployment and high inflation rate.
* **Demand pull and Cost push inflation**

**Demand pull inflation**

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|  | **Demand pull inflation** |
| Description | * Aggregate demand in an economy is higher than aggregate supply, even though gross domestic product rises and unemployment falls. * Too much money is spent chasing too few goods. |
| Causes (possible essay questions) | \*Increase in household consumption   * Decline in savings * Tax reduction * Access to credit   \*Investors’ expenditure  \*Government expenditure  \*Export services |

**Cost push inflation**

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|  | **Cost push inflation** |
| Description | * 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. |
| Causes (possible essay questions) | \**Increase in* Wages  \**Expensive* Key inputs  \*Exchange rate depreciation  \**Increase* in Profit margins  \**Lower* Productivity  \*Natural disaster  *(Adding the words in italics will help in explaining each cause)* |

* Consequences of inflation
* Measures to combat inflation- depend on the type of inflation

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| **Demand-pull inflation** | **Cost-push inflation** |
| **Monetary policy** –measures taken by the South African Reserve Bank by:  -**reducing money supply**  - **increasing repo rate** /interest rate to encourage savings  - **applying moral pressure** (moral suasion) on financial institutions to be more careful when granting credit  -**restricting granting of credit** to banks  **Fiscal policy:** measures taken by the Minister of Finance regardingtaxation and expenditure.  • An **increase in direct taxation** (personal income tax) which will help to decrease demand.  • An **increase in indirect taxation (VAT)** causes spending to decrease because goods become more expensive.  • A **loan levy. Reduces the disposable income** of consumers.  • 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. | * **Productivity** * **Competition** |

* Inflation targeting and its effectiveness
* Inflation targeting is a transparent way to explain interest rate policy and to manage consumers' expectations about future inflation.
* With the inflation target of 3-6% the public knows that if inflation gets out of the target, the central bank will take action.
* This certainty can stimulate economic activity.
* Businesses are able to make investment decisions knowing that prices will be stable.
* It provides an explicit measure that serve to improve discipline and accountability of the SARB
* However, the policy is ineffective in dealing with cost push inflation.
* Factors that cause cost push inflation are outside the control of the monetary authorities.

**TEST YOUR KNOWLEDGE AND UNDERSTANDING**

**ACTIVITY 1**

1.1 Give a term/concept for the descriptions below.

* + 1. An increase in the prices of goods due to higher input cost
    2. A regulated product used by motorists
    3. High unemployment, a high inflation rate and low economic growth
    4. A sustained increase in the general price level
    5. This indicator measures the increase in the cost of production
    6. The price level rises so rapidly that people lose confidence in the value of money.

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| 1.2 | Study the table below and answer the questions that follow. | | | | |  |
|  | **Year** | | **Average Price of a Basket of Goods** | **CPI** | **Inflation Rate** |  |
|  | 2010 | | R200 | 100 | ----- |  |
|  | 2011 | | R214,29 | 107,1 | 7.1 |  |
|  | 2012 | | R223,41 | 111,7 | 4.3 |  |
|  | 2013 | | R234,58 | 117,3 | 5,0 |  |
|  | 2014 | | R248,10 | **A** | 6,8 |  |
|  | *[Source: Stats SA 2015]* | | | | |  |
|  | 1.2.1 | Which year is considered the base year from the table? | | | | (1) |
|  | 1.2.2 | What tendency did the inflation rate show over the last three years? | | | | (1) |
|  | 1.2.3 | Explain the concept CPI. | | | | (2) |
|  | 1.2.4 | Why do people lose confidence in their currency during hyperinflation? | | | | (2) |
|  | 1.2.5 | Calculate the CPI as indicated by the letter **A**. Show all calculations. | | | | (4) |

**ACTIVITY 2**

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| 2.1 |  | Study the information below and answer the questions that follow. |  |
|  |  | Source: *http://www.tradingeconomics.com/south-africa/core-inflation-rate* |  |
|  | 2.1.1 | Identify the quarter during which the core inflation rate was at its lowest. | (1) |
|  | 2.1.2 | Which institution in South Africa calculates the official inflation rate? | (1) |
|  | 2.1.3 | Briefly describe the term *core inflation*. | (2) |
|  | 2.1.4 | How does inflation affect the real value of money? | (2) |
|  | 2.1.5 | In your opinion what could the Reserve Bank have done to prevent the increase in the inflation rate in December 2016? | (4) |
|  |  |  |  |
| 2.2 | How would a low inflation rate benefit South Africa’s economy? | | 8 |
| **ACTIVITY 3** | | |  |
| 3.1 | Give a term/concept for the descriptions below | | (1) |
|  | 3.1.1 | Measures by Minister of Finance to combat inflation | (1) |
|  | 3.1.2 | The institution used by Monetarists to combat inflation | (1) |
|  | 3.1.3 | 3 – 6% band | (1) |
|  | 3.1.4 | The inflation that is used in the measuring of the official inflation rate | (1) |
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| 3.2 |  |  |  |
|  |  | **CHANGES IN FUEL PRICES ARE HERE TO STAY**  The Department of Energy has announced that the petrol price will increase by 0,52c a litre, while the price of diesel will increase by 0,76c from 1 June.  The price of paraffin will increase by 0,62c a litre.  The department's Robert Maake says, “The main reasons for these increases include the high crude oil prices, which led to high prices of petroleum products in the market and the depreciation of the rand against the US dollar during the period under review.”  This is the second petrol price increase in the space of a month, as it went up by 0,12c per litre on 4 May 2016.  Diesel went down by between one and two cents per litre, while illuminating paraffin decreased by 0,09c per litre.  Eyewitness News | 30 April 2016 (Edited by Winnie Theletsane) |  |
|  | 3.2.1 | Identify the institution which announces the monthly change in fuel prices. | 1 |
|  | 3.2.2 | Give ONE reason for the monthly changes in fuel prices. | 1 |
|  | 3.2.3 | Briefly explain why the government see fuel levies as a very popular source of income. | 2 |
|  | 3.2.4 | Distinguish between fuel levies and the normal monthly change in fuel prices | 2 |
|  | 3.2.5 | How does an increase in fuel prices impact on the country’s inflation rate? | 4 |

**ACTIVITY 4**

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| 4.1 | Answer the following questions appropriately | |  |
|  | 4.1.1 | What is the impact of inflation on the individual taxpayer? | 8 |
|  | 4.1.2 | What is the impact of inflation on *investors* and *savers?* | 8 |
|  | 4.1.3 | To what extent is inflation targeting beneficial to the economy? | 8 |
|  |  |  |  |

**POSSIBLE ESSAYS- MAIN PART**

*1 Discuss in details the causes of demand-pull inflation. (30)*

*2 Discuss in details the causes of cost-push inflation. (30***)**

**TOURISM**

* *Description*: Tourism can be defined as activities of **people travelling to places outside** their usual environment for **less than one year** for **business**, **leisure** or other purposes **without any remuneration.**

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 160 km** from the tourist’s home environment.

**CONTENT TO BE COVERED**

* **Types** of tourism
* **Measuring**  tourism
* The **reasons** for growth in the tourism industry (internationally and domestically)
* The effects of tourism – (*possible essay question*)

There positive and negative effects

- GDP

- Employment

- Poverty

- Externalities

- Environment

- Investment

* **Benefits** of tourism (*possible essay question*)

- Households

- Businesses

- State

- Infrastructure development

* South Africa's **tourism profile** under the following headings:

- Aim with visits

- Local destinations

- Local tourists

- Indigenous knowledge

* Broadly outline the Department of Tourism's **policy suggestions** under the following headings:

- Marketing

- Spatial distribution

- Taxing

- Infrastructure development

**TEST YOUR KNOWELEDGE AND UNDERSTANDING**

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| **ACTIVITY 1** | | | |
| 1.1 |  |  |  |
|  | 1.1.1 | Name any four types of tourism | 4 |
|  | 1.2.2 | What five activities should tourism comply with? | 5 |
|  |  |  |  |
| 1.2 | **Data Response** | |  |
|  | **Study the information below and answer the questions that follow.** | |  |
|  |  |  |  |
|  |  |  |  |
|  | 1.2.1 | Identify TWO purposes in the table above why South Africans travelled domestically. | (2) |
|  | 1.2.2 | Briefly describe the term *domestic tourism.* | 2 |
|  | 1.2.3 | What is a possible reason for the decline in holiday trips between 2015 and 2016? | 2 |
|  | 1.2.4 | Calculate the number of people who undertook business trips in 2016. Show ALL calculations. | (4) |

**ACTIVITY 2**

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|  | 2.1 | Explain the effects of tourism on the *environment* and *poverty*.  The environment |  |

**ACTIVITY 3**

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| --- | --- | --- | --- |
|  | 3.1 | Name TWO world heritage sites in South Africa**.** | 2 |
|  | 3.2 | Read the information below and answer the questions that follow. |  |
|  |  | **WEAK RAND CAN BENEFIT SOUTH AFRICA'S TOURISM**  South Africa's currency has reached its lowest level since 2001. This is great news for international tourists who can take advantage of a very favourable exchange rate to visit South Africa. Now, more than ever, South Africa offers great value for money and has become one of the greatest holiday destinations for international travellers.  South Africa offers vacation options to suit every pocket and taste. Travellers are truly spoilt for choice from hotel and safari lodge accommodation, restaurants offering local and international cuisine, access to the Big Five wildlife and spectacular, breath-taking scenery.  [*Source: www.eturbonews.com* |  |
|  | 3.2.1 | Identify TWO goods or services on which tourists can spend money in South Africa in the extract above. | 2 |
|  | 3.2.2 | Explain the term *tourism*. | 2 |
|  | 3.2.3 | How does a weaker rand affect the South African tourist? | 2 |
|  | 3.2.4 | How can an increase in tourism benefit South African households? | 4 |

**ACTIVITY 4**

|  |  |  |  |
| --- | --- | --- | --- |
|  | 4.1 | Explain the effects of increased tourism on poverty. | 8 |
|  | 4.2 | How can indigenous knowledge systems (IKS) be used to increase tourism in South Africa? |  |

**ENVIRONMENTAL SUSTAINABILITY**

TOPICS TO BE COVERED

* **The state of the environment** under the following headings:

- Pollution (Definition and types)

- Erosion

- Deforestation

- Climate change

- Conservation

- Preservation

* **The markets used to ensure sustainability**

- The market does not take care of social costs and benefits

- The market fails because of specific reasons

- The mechanism of the market and social costs and benefits

* **How the government can ensure sustainable development:**

- Grant property rights

- Pay for environmental use

- Levy environmental tax

- Pay environmental subsidies

- Issue marketable permits

- Command and control

- Voluntary agreements

- Education

* **Problems** and the **international measures** taken to ensure sustainable development :

|  |  |
| --- | --- |
| **PROBLEM** | **INTERNATIONAL MEASURE TAKEN** |
| **Biodiversity loss**  Biodiversity refers to a number of different species and sub-species found in a specific area.  Due to extinction of the diversity of life forms on the planet decreases.  Extinction is an irreversible process which means once those species are lost it is for ever. | **The Convention on International Trade in Endangered Species (CITES**) sets many policies to deal with species loss. |
| **Chemical waste**  Exposure to certain chemicals can lead to toxicity in living organisms.  Such exposure can lead to immediate death, death after time or infertility in human beings, plant and animals.  In normal concentration some chemicals are not toxic, while others such as DDT which is an insecticide are toxic by nature.  Production of chemicals lead to chemical waste and getting rid of such waste always create environmental problems. | **Stockholm Protocol on Persistent Organic Pollutants** bans the most dangerous manufactured substances such as DDT.  The **Rotterdam Convention** protects countries that lack adequate infrastructure to monitor the imports and exports of dangerous chemicals. |
| **Hazardous waste**  It is not limited to chemical wastes but include toxic metal waste such as lead and mercury, radioactive waste, inorganic compounds such as such as pesticides.  These wastes are dangerous to the ecosystem as a whole.  Due to their slow decomposition process, they tend to accumulate in the environment for a very long time. | The **Basel Convention** controls the import and export of hazardous waste.  Trade can only take place between countries that signed the convention.  Trade can only take place if the wastes are handled in an environmentally friendly manner.  South Africa is a party to the Basel Convention |
| **Climate change- adaptation and mitigation**  Climate change is the change in the composition of the atmosphere that is related to human activity.  A build-up of greenhouse gases causes the heat from the sun to be trapped in the atmosphere leads to global warming.  Global warming has an effect on world’s weather patterns which include extreme temperatures and change in rainfall patterns. | In 1997 the Kyoto protocol was signed due to lack of success of the UNFCCC.  The aim of Kyoto protocol was for developed countries to reduce their greenhouse emissions by 5.2% by 2012. Developed countries were also to provide some financial assistance to developing countries to use clean technologies. |
| **Indigenous knowledge**  Indigenous knowledge refers to the knowledge that indigenous people in a particular area use to make a living.  Traditional people used organic methods and natural processes in production.  Local capacity building among indigenous people is important aspects of sustaining the environment.  Capacity building involves equipping indigenous people with environmental knowledge beyond their traditional belief.  This can provide a foundation from which to develop alternative ways of managing resources. | In 2007 the **UN’s declaration on Rights of Indigenous Persons** was adopted.  The declaration sets the standard for protection of rights of indigenous people. |

* The major **international protocols and agreements** on sustainable development:

- Rio de Janeiro summit (UNCED)

- Johannesburg summit (WSSD)

- Rio + 20 summit

- Kyoto Protocol

- Millennium Development Goals

- United Nations Framework Convention on Climate Change

- Conference of the Parties (COP17)

**TEST YOUR KNOWLEDGE AND UNDERATANDING**

**ACTIVITY 1**

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|  |  |  |  |
| 1 | 1.1 | Study the information and answer the questions that follow. |  |
|  |  |  |  |
|  | 1.1.1 | Clearly distinguish between the actions of the two divers above | 1 |
|  | 1.1.2 | Identify the motive behind the destruction of the coral reefs | 1 |
|  | 1.1.3 | Briefly describe the term *environmental sustainability* | 2 |
|  | 1.1.4 | Why is it important to conserve/protect our coral reefs? | 2 |
|  | 1.1.5 | What can the government do to prevent the destruction of the coral reefs? | 4 |
|  |  |  |  |
|  | 1.2 | Why are CO2 gasses bad for the environment? | 2 |
|  | 1.3 | How can *conservation* and *preservation* contribute to a better environment? | 8 |
|  |  |  |  |

ACTIVITY 2

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| --- | --- | --- | --- |
|  | 2.1 | How does the lack of knowledge (ignorance) by businesses contribute to  climate change? | 2 |
|  |  |  |  |
|  | 2.3 | Distinguish between land pollution and water pollution. | 8 |

ESSAYS- Main part

* *Discuss in detail how the government can ensure sustainable development (30)*
* *Discuss FIVE problems in environmental sustainability and international measures taken to ensure sustainable development (30)*