Province of the

EASTERN CAPE

EDUCATION

DIRECTORATE SENIOR CURRICULUM MANAGEMENT (SEN-FET)

HOME SCHOOLING SELF-STUDY ANSWER SHEET

SUBJECT	**ECONOMICS**	**GRADE**	12	**DATE**	**09/07/2020**
TOPIC	**CONTEMPORARY ECONOMIC ISSUES**	**TERM 1 REVISION**		**TERM 3 CONTENT**	x

QUESTION 1 CONTEMPORARY ECONOMIC ISSUES 40 MARKS – 40 MINUTES

- Examine in detail the causes of cost-push inflation. (26 marks)
- Analyse the negative impact of administered prices on the economy. (10 marks)

(DBE/Nov 2019) **[40]**

INTRODUCTION

Inflation is a sustained and considerable increase in the general price level over a particular period / Cost-push inflation is the result of an imbalance between supply and demand due to cost factors, usually where an inelastic demand is found √√
(Accept any other correct, relevant response) **Max (2)**

MAIN PART

Wages √

- Wage increases that are higher than productivity cause a cost increase for producers √√
- Single most important cost item in any economy and contributes most to the value added to basic prices √√
- An increase in administered prices may result in trade unions demanding higher wages, because producers may simply add the increase to the price of the final product √√ **(Max 2)**

Strikes and stayaways √

- Strikes reduce production output and cause a drop in the supply √√

Taxes √

- An increase in direct taxes may lead producers to increase prices to offset their extra tax burden √√
- An increase in indirect taxation such as VAT, customs or excise duty will be added to the final price √√

Key inputs √

- When the price of imported key inputs increases, the domestic costs of production increase resulting in imported inflation √√
- Producers recover these costs by increasing the prices of their products √√
- The high cost of inputs in the agricultural sector such as diesel and fertilisers are added to the price of products √√
- Supply-shocks might have a knock-on effect on other products due to higher fuel prices and transport costs √√

Profit margins √

- When businesses push up their profit margins / the monopoly-effect, they increase the cost of production and the price that the consumers have to pay, contributing to inflation √√
- This is because manufacturers recover the higher prices they have to pay by increasing their prices √√
- In the US ethanol production was subsidised which caused farmers to switch to corn production for energy. This led to a shortage of food and led to an increase in prices √√

Productivity √

- If various factors of production become less productive while still receiving the same remuneration, the cost of producing each unit of output increases √√
- A systematic drop in productivity while employment and wages remain constant √√

Exchange rate √ •

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

Natural disasters √

- Disasters, such as floods and droughts, affect the cost of production negatively √√
- Food prices is one of the most volatile price items as a result of the effect of weather changes √√
- External shocks like OPEC controlling the world's oil supply/natural disasters leading to low production √√
- Exhaustion of natural resources leads to limited supply which will increase prices for example fish stocks √√

Theft by employees/Shoplifting √

- Many businesses make provision for losses caused by theft by employees and shoplifting, which increases the prices of goods √√
- Cost of installing security measures increases the input costs √√

Interest rates √

- An increase in interest rates means businesses will pay more for loans – this increase may also be added to the selling price √√
- An increase in international borrowing and national debts affects interest rates that affects prices to rise √√

Low savings levels √√

- Low savings lead to limited investment which pose a barrier to expand production capacity decreasing the supply of goods √√
  (Allocate a maximum of 8 marks for mere listing of facts/examples) (Accept any other correct relevant response) **Max (26)**

ADDITIONAL PART

Administered priced goods impact the economy negatively because:

- the government has not been able to keep administered prices within the inflation target range (above 10%) √√
- a significant number of administered priced goods is used in the calculation of the CPI and puts pressure on prices that limits competitiveness √√
- sharp increases in the prices of electricity, water tariffs and municipal services has threatened the mining and manufacturing capacity causing foreign investors to withdraw their investments √√
- the government has limited control over fuel price increases which is determined by the exchange rate (the depreciation of the rand) and international oil prices √√
- the increases in fuel prices (above the inflation target of 6%) has increased the cost of production of all goods and services √√
- the cost of the CPI basket of goods will increase further due to increased transport costs √√
- the increased transport cost will limit the supply of goods, impacting negatively on the consumer through higher market prices √√
- the price of fuel in South Africa includes various levies for example the road accident fund, which has increased above the CPI √√
- the increased pressure on the CPI can lead to a situation of stagflation (high unemployment, low growth and high inflation) √√

(Accept any other correct relevant higher order responses) **(Max 10)**

CONCLUSION

It is important for a country to implement various measures to control inflation, as its consequences can be devastating. √√

Max (2) [40]