

MULTIPLE CHOICE:

- The 3 major flows in the economy as a whole are total production, total income and total spending.
- 2 basic participants are households and firms
- Stock variable – eg balance in a savings account on a particular day
- Consumption is a flow variable
- Capital a stock variable
- Members of a household are called consumers
- Consumers are rational in other words they will always try to maximize their satisfaction given the means at their disposal
- Households responsible for the spending on consumer goods
- Capital goods are purchased by firms
- 2 sets of markets in the economy – goods markets (market for tomatoes) and factor markets (labour market)
- Firms purchase in the factor markets and sell in the goods market
- Households sell in the factor markets and purchase in the goods markets
- Major flows associated with the government are – government spending, taxes and transfer payments
- Taxes = leakage from circular flow of income and spending
- Government spending = injection into the circular flow of income
- The foreign sector is linked to the domestic flow of income and spending through imports and exports
- Savings, imports, taxes = withdrawal
- Investment, exports, government spending = injection
- C = spending by households on consumer goods and services
- I = spending by firms on capital goods
- G = spending by government on goods and services
- X = Spending by foreigners on SA goods and services - (minus) S.A imported goods and services (Z)
- TOTAL EXPENDITURE = $C + I + G + X - Z$

THE MONETARY SECTOR

- Money can be defined as anything that is generally accepted as payment of goods and services or that is accepted in settlement of debt. (Money is what money does).
- Barter economy is an economy that operates without money where goods are exchanged for other goods.

The functions of money:

1. **Medium of exchange** - Money serves as a lubricant or intermediary to smooth the process of exchange and to make it more efficient.

- Progressive – ratio of tax paid to taxable income increases as taxable income increases – higher bracket income earned higher percentage tax is paid
- proportional – ratio tax paid to taxable income is the same at all levels of income.(company tax)
- Regressive – ratio between tax paid and taxable income decreases as taxable income increases.
- Personal income tax – most important form of direct tax in S.A.
Marginal tax rate is the rate at which each additional rand of income is taxed. Average tax rate is the ration between the amount of tax paid and taxable income. Average tax is also called the effective tax rate. Personal income tax is a progressive tax
- CGT – gains resulting from the sale of assets such as shares and investments and immovable property.
- Company tax – STC – proportional tax – this tax is levied on all profits distributed to shareholders in the form of dividends
- VAT – most important indirect tax in S.A. – regressive tax. 14% rate

Multiple choice

1. general government consists of central, provincial and local government
2. The existence of externalities prevents the attainment of socially efficient allocation of resources in the economy.
3. Market systems tend to generate unequal distributions of personal income.
4. The allocation function of government refers to actions by government to promote an efficient allocation of resources in the economy.
5. Government failure arises when politicians, bureaucrats and other interest groups put their own interest before those of society at large.
6. Privatisation could improve efficiency bit it could have an adverse impact on employment.
7. changes in taxes and government expenditure represent fiscal policy decisions
8. Government could use the budget to try to influence variables such as total production, income, employment and to redistribute income in the economy.
9. Changes in level and composition of government spending sometimes reflect changes in society priorities but could also be the result of the influence of powerful special interest groups.
10. Political shocks and other major disturbances could exert strong upward pressure on government spending.
11. excessive or unrealistic expectations about what government can deliver could exert upward pressure on real government spending
12. both a rapidly growing population and a high rate of urbanization tend to exert upward pressure of government spending

- 13. The budget deficit or surplus is the difference between government spending and current revenue –mainly taxes.
- 14. If government finances part of its spending by borrowing from the central bank this is called inflationary financing.
- 15. taxes that distort relative prices inhibit the functioning of the market mechanism and are not neutral
- 16. An admission fee at a public swimming pool is an example of user charging.
- 17. tax evasion illegal
- 18. a tax is progressive if lower income groups pay a smaller % of their taxable income in the form of tax than higher income groups

FOREIGN SECTOR

- One of the basic reasons for international trade is the fact that factors of production (natural resources, labour, capital and entrepreneurship) are not evenly distributed among the nations of the world
- **Absolute advantage** – this is when a country requires fewer resources to produce a specific goods, they therefore have the absolute advantage in that industry. This is however not a prerequisite for international trade.

Comparative or relative advantage – each country will tend to specialize in and export those goods in which it has a comparative advantage. International trade will only occur if comparative advantages exist that is if the opportunity costs differ between countries

Sources of comparative advantage:

- (a) Technology – if a country possess a production process that is technologically superior to processes used by other countries
- (b) Resource endowments – one of the most important explanations of each country's comparative advantage lies in the fact that different countries are endowed with different quantities of scarce resources. **Heckscher-ohlin theory** – each country will tend to export those goods that most intensively use the country's relatively abundant resources.

Trade policy:

- (a) Import tariffs – are duties or taxes imposed on products imported into a country. Used to protect domestic firms against competition from imports (protective tariffs) or to raise government revenue (revenue tariffs)
- (b) Specific tariffs – is a fixed amount that is levied on each unit of the imported commodity.

- a farmer in free state buys a tractor from his neighbor – transaction not recorded in BOP
- In the simple Keynesian model equilibrium is attained where aggregate demand is equal to aggregate supply.
- consumption spending consists of autonomous spending and induced spending
- if the marginal propensity to save is $1/3$, the marginal propensity to consume is $2/3$
- in the simple Keynesian model if aggregate demand exceeds aggregate supply production must increase to reach equilibrium
- Along the 45 degree line aggregate demand is equal to aggregate supply.
- according to say's law supply will create its own demand, at equilibrium there is full employment
- according to the Keynesian model equilibrium does not necessarily imply full employment
- if $c = 2/3$ then the multiplier is $= 3$
- taxes decrease the size of the multiplier
- if aggregate spending is 1200 and aggregate production is 1300 there is unplanned increase in inventories
- negative net exports will shift the aggregate demand curve downwards
- if the equilibrium level of income is below the full employment level, full employment can be reached by increasing autonomous consumption
- a change in marginal propensity to consume will change the size of the multiplier
- a decrease in the tax rate will increase induced consumption
- Investment is negatively related to the interest rate.
- government spending is independent of the level of income
- an increase in income will increase induced consumption
- imports are independent of the level of income
- The equilibrium level of income is determined by multiplying the multiplier by autonomous aggregate demand.
- Negative net exports will shift the aggregate demand curve downwards.
- autonomous aggregate demand – $A = C + I + G + (X - Z)$
- AD – AS model – the general price level and total production of goods and services
- the AD curve indicates the level of total expenditure at various price levels in the economy
- in the AD – AS curve model prices are assumed to vary
- a decrease in the price of imported crude oil will reduce the costs of production and the AS curve will shift to the right
- the monetary transmission mechanism starts with a change in the interest rate
- government spending and taxes are 2 basic instruments of fiscal policy
- recognition, decision, implementation and impact lags are four types of policy lags

- a reduction in government spending is an example of contractionary fiscal policy
- A decrease in the repo rate by the SARB is an example of expansionary monetary policy.
- a simultaneous increase in the price level and the level of production could be the result of an increase in investment spending
- inflation is the continuous and considerable increase in prices in general
- demand-pull inflation can be caused by expansionary monetary and fiscal policy measures
- a depreciation of SA rand will increase the price of imported goods
- cost-push inflation is triggered by increases in the cost of production
- high inflation in SA can damage the countries international competitiveness
- cost-push inflation leads to higher prices , decreased production and higher unemployment
- an increase in the aggregate demand for goods and services can reduce cyclical unemployment
- the costs of unemployment can be reduced through the availability of unemployment benefits and other social welfare programmes
- An increase in aggregate demand for goods and services can reduce cyclical unemployment.
- an unemployment steam locomotive driver is a victim of structural unemployment
- seasonally unemployment – only employed during a specific season (life guard that works during summer)
- frictionally unemployed – one quits a job in one place to find another job in a different place
- voluntarily unemployed – not bothered to find a job
- demand factors is one of the major sources if economic growth
- when measuring economic growth changes in prices and population should be taken into account
- economic development and economic growth are both particularly important issues in SA
- real GDP is obtained by adjusting nominal GDP for inflation
- GDP per capita is calculated by multiplying GDP by the number of people in the population
- If real GDP increased by 5% from one year to the next, SA undoubtedly experienced economic growth during this period.
- a flow variable is measured over specific period
- stocks can change as a result of flows
- in the circular flow of income and spending savings result in a decrease in the volume of the income flow
- financial institution acts as intermediary between those who save and those who wish to invest
- provincial government = government