

Advanced Economics Notes - Grade 12

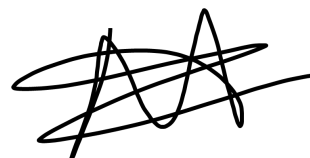
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Contents

Unit 1: The Fundamental Concepts of Macroeconomics	2
Unit 2: Aggregate Demand and Aggregate Supply Analysis	3
Unit 3: Market Failure and Consumer Protection	6
Unit 4: Macroeconomic Policy Instruments	8
Unit 5: Tax Theory and Practice	12
Unit 6: Poverty and Inequality	14
Unit 7: Macroeconomic Reforms in Ethiopia	16
Unit 8: Economy, Environment, and Climate Change	19



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Unit 1: The Fundamental Concepts of Macroeconomics

1.1 Definition and Focus Areas of Macroeconomics Revisited

- **Macroeconomics:** The study of the economy as a whole, focusing on broad issues such as economic growth, inflation, unemployment, and government policy.
- **Focus Areas:**
 - Economic Growth
 - Inflation
 - Unemployment
 - Business Cycles
 - Balance of Trade
 - Macroeconomic Policies

1.2 Key Challenges in Macroeconomics

- **Economic Growth:** A sustained increase in a country's real GDP over time.
- **Inflation:** A sustained increase in the general price level of goods and services.
- **Unemployment:** People who are willing and able to work but cannot find jobs.
- **Business Cycles:** Fluctuations in a country's real GDP over time, marked by periods of expansion (growth) and contraction (recession).
- **Balance of Trade:** The difference between a country's exports and imports.

1.3 The Schools of Thought in Macroeconomic Analysis

1.3.1 Evolution and Recent Developments

- **Classical Economics:** Emphasis on free markets, flexible prices, and a self-correcting economy.

- **Keynesian Economics:** Focus on the role of aggregate demand, sticky prices, and government intervention to stabilize the economy.
- **Monetarism:** Emphasis on the role of money supply and monetary policy in influencing economic activity.
- **New Classical Economics:** Emphasizes rational expectations and flexible prices.
- **New Keynesian Economics:** Integrates elements of Keynesian and classical thought, acknowledging both market imperfections and the importance of monetary policy.



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Unit 2: Aggregate Demand and Aggregate Supply Analysis

2.1 Aggregate Demand

- **Aggregate Demand (AD):** The total amount of goods and services that buyers are willing and able to purchase at each price level.
- **Components of AD:**
 - **Consumption (C):** Spending by households.
 - **Investment (I):** Spending by businesses.
 - **Government Purchases (G):** Government spending.
 - **Net Exports (NX):** Exports minus imports.

2.1.1 The Aggregate Demand Curve

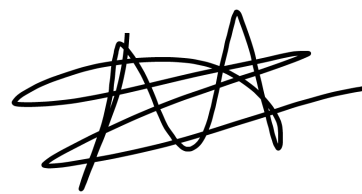
- **Definition:** A curve that shows the relationship between the price level and the quantity of real GDP demanded.
- **Downward Slope:** The AD curve slopes downward, reflecting the inverse relationship between the price level and quantity demanded.
- **Reasons for the Downward Slope:**
 - **Real Balance Effect:** A higher price level reduces the real value of money balances, decreasing spending.
 - **Interest Rate Effect:** A higher price level increases the demand for money, raising interest rates, and decreasing investment and consumption spending.
 - **International Trade Effect:** A higher price level makes a country's goods more expensive relative to foreign goods, reducing exports and increasing imports, leading to a decrease in net exports.

2.1.2 Shifts in the Aggregate Demand Curve

- **Factors That Shift the AD Curve:**
 - **Changes in Consumption:** Factors that affect consumer spending, such as changes in wealth, consumer confidence, or taxes.
 - **Changes in Investment:** Factors that affect business spending, such as changes in interest rates, business confidence, or taxes.
 - **Changes in Government Spending:** Increases or decreases in government spending.
 - **Changes in Net Exports:** Factors that affect exports and imports, such as changes in foreign income, exchange rates, or trade policies.

2.2 Aggregate Supply

- **Aggregate Supply (AS):** The total quantity of goods and services that firms are willing and able to produce at each price level.
- **Short-Run Aggregate Supply (SRAS):** Upward sloping, reflecting the idea that firms can increase output in the short run as the price level rises.
- **Long-Run Aggregate Supply (LRAS):** Vertical, reflecting the idea that in the long run, the economy produces at its potential output level, regardless of the price level.



2.2.1 Why the SRAS Curve is Upward Sloping

- **Sticky Wages:** Nominal wages are slow to adjust to changes in the price level, leading to changes in real wages.
- **Worker Misperceptions:** Workers may misperceive changes in the price level, leading to changes in labor supply.

2.2.2 Why the LRAS Curve is Vertical

- **Full Employment:** In the long run, the economy operates at its full employment level of output, which is determined by factors such as the size of the labor force, capital stock, and technology.

2.2.3 Shifts in the Aggregate Supply Curves

- **Factors That Shift the SRAS Curve:**
 - **Changes in Input Prices:** Changes in wage rates, oil prices, or other input costs.
 - **Changes in Productivity:** Improvements in technology or efficiency.
 - **Changes in Taxes or Subsidies:** Government policies that affect business costs.
- **Factors That Shift the LRAS Curve:**
 - **Changes in the Size of the Labor Force:** Increases or decreases in population or labor force participation.
 - **Changes in the Capital Stock:** Increases or decreases in the amount of physical capital available.
 - **Technological Advancements:** Innovations that improve productivity.

2.3 Equilibrium of Aggregate Demand and Aggregate Supply

- **Macroeconomic Equilibrium:** Occurs where the AD curve intersects the AS curve.
- **Short-Run Equilibrium:** Where the AD curve intersects the SRAS curve.
- **Long-Run Equilibrium:** Where the AD curve intersects the LRAS curve.

2.3.1 Shocks to Aggregate Demand

- **Demand Shocks:** Unexpected changes in aggregate demand that can cause shifts in the AD curve.
- **Expansionary Demand Shock:** Shifts the AD curve to the right, increasing output and the price level.
- **Contractionary Demand Shock:** Shifts the AD curve to the left, decreasing output and the price level.

2.3.2 Shocks to Aggregate Supply

- **Supply Shocks:** Unexpected changes in aggregate supply that can cause shifts in the AS curve.
- **Expansionary Supply Shock:** Shifts the AS curve to the right, increasing output and decreasing the price level.
- **Contractionary Supply Shock:** Shifts the AS curve to the left, decreasing output and increasing the price level.



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Unit 3: Market Failure and Consumer Protection

3.1 Market Failure

- **Definition:** A situation where the free market fails to allocate resources efficiently or distribute goods and services equitably.
- **Causes:**

- **Externalities:** Costs or benefits that affect third parties not involved in the transaction.
- **Public Goods:** Goods that are non-excludable and non-rivalrous.
- **Asymmetric Information:** One party in a transaction has more information than the other.
- **Monopolies:** Single sellers with market power that can lead to higher prices and less output.

3.2 Public Goods

- **Definition:** Goods that are non-excludable (people cannot be prevented from consuming them) and non-rivalrous (one person's consumption doesn't reduce the amount available for others).
- **Examples:** National defense, clean air, knowledge.
- **Free Rider Problem:** Individuals may benefit from public goods without contributing to their cost.

3.3 Externalities

- **Definition:** Costs or benefits that affect third parties not involved in the transaction.
- **Types:**
 - **Negative Externalities:** Costs imposed on third parties (e.g., pollution).
 - **Positive Externalities:** Benefits conferred on third parties (e.g., education, vaccinations).

3.4 Asymmetric Information

- **Definition:** One party in a transaction has more information than the other.
- **Types:**
 - **Adverse Selection:** When one party cannot observe the quality of the good being traded (e.g., used cars).
 - **Moral Hazard:** When one party cannot observe the actions of the other (e.g., insurance).

3.5 Consumer Protection

- **Definition:** Measures taken to safeguard the interests and rights of consumers.
- **Need for Consumer Protection:**
 - **Social Responsibility:** To ensure ethical business practices.
 - **Increased Consumer Awareness:** To empower consumers.
 - **Consumer Satisfaction:** To promote customer loyalty.
 - **Social Justice:** To ensure fair treatment.
 - **Business Survival and Growth:** To encourage responsible business behavior.



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Unit 4: Macroeconomic Policy Instruments

4.1 Definition and Types of Macroeconomic Policies

- **Macroeconomic Policies:** Government actions designed to influence the overall performance of the economy.
- **Types:**
 - **Fiscal Policy:** Government spending and taxation decisions.
 - **Monetary Policy:** Actions taken by a central bank to influence the money supply and interest rates.
 - **Income Policy:** Measures to control wages and prices, often used to combat inflation.

- **Foreign Exchange Policy:** Actions taken by a government or central bank to influence the exchange rate.

4.2 Fiscal Policy

- **Definition:** Government spending and taxation decisions to influence aggregate demand and the economy.

4.2.1 Tools of Fiscal Policy

- **Government Spending:** Increases or decreases in government spending.
- **Taxation:** Changes in tax rates or tax policies.

4.2.2 Types of Fiscal Policy

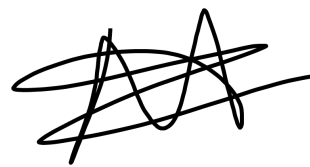
- **Expansionary Fiscal Policy:** Used to stimulate aggregate demand and the economy during a recession.
 - **Methods:** Increase government spending or cut taxes.
- **Contractionary Fiscal Policy:** Used to reduce aggregate demand and combat inflation.
 - **Methods:** Reduce government spending or raise taxes.

4.3 Monetary Policy

- **Definition:** Actions taken by a central bank to influence the money supply and interest rates.

4.3.1 Tools of Monetary Policy

- **Open Market Operations (OMO):** Buying or selling government securities to influence the money supply.
- **Discount Rate:** The interest rate at which commercial banks can borrow from the central bank.
- **Required Reserve Ratio (RRR):** The percentage of deposits that banks are required to hold in reserve.



4.3.2 Types of Monetary Policy

- **Expansionary Monetary Policy:** Used to stimulate aggregate demand and the economy during a recession.
 - **Methods:** Lower the discount rate, buy government securities, reduce the required reserve ratio.
- **Contractionary Monetary Policy:** Used to reduce aggregate demand and combat inflation.
 - **Methods:** Raise the discount rate, sell government securities, increase the required reserve ratio.

4.4 Income Policy and Wage

- **Income Policy:** Government policies aimed at controlling wages and prices, often used to combat inflation.
- **Minimum Wage:** The legally mandated minimum hourly wage rate.

4.5 Foreign Exchange Policies

- **Foreign Exchange Policy:** Government actions to influence the exchange rate.
- **Exchange Rate:** The price of one currency in terms of another.

4.5.1 Types of Exchange Rate Systems

- **Fixed Exchange Rate:** The government or central bank sets a fixed exchange rate.
- **Floating Exchange Rate:** The exchange rate is determined by market forces of supply and demand.

4.5.2 Impact of Exchange Rate Changes

- **Appreciation:** An increase in the value of a currency relative to other currencies.
- **Depreciation:** A decrease in the value of a currency relative to other currencies.

- **Devaluation:** A deliberate decrease in the value of a currency by a government.
- **Revaluation:** A deliberate increase in the value of a currency by a government.

4.5.3 Factors Affecting Exchange Rates

- **Inflation Rates:** Countries with lower inflation rates tend to have stronger currencies.
- **Interest Rates:** Higher interest rates can attract foreign investment, leading to currency appreciation.
- **Balance of Payments:** A trade surplus or capital inflows can lead to currency appreciation.
- **Government Debt:** High government debt can lead to currency depreciation.
- **Terms of Trade:** Improved terms of trade (higher export prices relative to import prices) can lead to currency appreciation.
- **Political Stability:** Countries with greater political stability tend to have stronger currencies.
- **Economic Growth:** Strong economic growth can attract investment and lead to currency appreciation.
- **Speculation:** Expectations about future currency movements can affect exchange rates.



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Unit 5: Tax Theory and Practice

5.1 Taxes: Definition, Principles, Objectives, and Classifications

- **Definition:** Compulsory, unrequited payments to the government.

5.1.1 Objectives of Taxation

- **Revenue Generation:** To finance government spending.
- **Redistribution of Income and Wealth:** To reduce income inequality.
- **Discouraging Harmful Behavior:** To reduce consumption of unhealthy or socially harmful goods.
- **Stabilizing the Economy:** To moderate business cycles.

5.1.2 Principles of Taxation

- **Ability to Pay:** Those with greater ability to pay should contribute more.
- **Benefits Received:** Taxpayers should contribute in proportion to the benefits they receive from government services.
- **Certainty:** Taxes should be clear and predictable.
- **Convenience:** Taxes should be easy and convenient for taxpayers to pay.
- **Economy:** The costs of collecting taxes should be minimized.
- **Flexibility:** The tax system should be adaptable to changing economic conditions.

5.1.3 Characteristics of a Good Tax System

- **Equitable:** Fair and just.
- **Efficient:** Minimizes costs and distortions.
- **Simple and Transparent:** Easy to understand and comply with.
- **Flexible:** Adaptable to changing economic conditions.

5.1.4 Classifications of Taxes

- **Direct Taxes:** Taxes on income and wealth (e.g., income tax, property tax).
- **Indirect Taxes:** Taxes on goods and services (e.g., value-added tax, excise tax, sales tax).

5.1.5 Approaches to Tax Equity

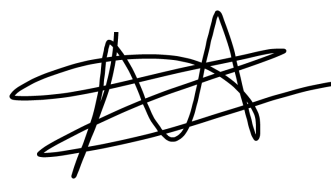
- **Benefits Approach:** Taxpayers should contribute in proportion to the benefits they receive from government services.
- **Ability-to-Pay Approach:** Taxpayers should contribute based on their ability to pay (e.g., progressive, proportional, or regressive taxes).

5.2 Tax System and Structure in Ethiopia

- **Federal Ministry of Revenue (MoR):** Responsible for tax administration in Ethiopia.
- **Tax Proclamation No. 286/2002 and Regulations No. 78/2002:** The legal framework for taxation.
- **Tax Schedules:**
 - **Schedule A:** Income from employment.
 - **Schedule B:** Income from rental of buildings.
 - **Schedule C:** Income from business.
 - **Schedule D:** Other income.
 - **Schedule E:** Exempt income.

5.3 Types of Tax and Tax Accounting in Ethiopia

- **Types of Taxes in Ethiopia:** Income tax, rental income tax, business income tax, value-added tax (VAT), turnover tax (TOT), excise tax, surtax, pension contributions, withholding tax, stamp duty, customs duty.
- **Tax Accounting:** The process of calculating and recording financial information for tax purposes.



5.4 Problems Associated with Taxation in Ethiopia

- **Tax Compliance:** Tax avoidance (legal) and tax evasion (illegal).
- **Bureaucracy:** Complexity of the tax system, corruption, cost of compliance, and lack of tax knowledge.



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Unit 6: Poverty and Inequality

6.1 Concept of Poverty and Its Measurement

- **Poverty:** A state of deprivation of basic needs, including food, shelter, healthcare, and education.
- **Types of Poverty:**
 - **Absolute Poverty:** Lack of basic necessities, defined by a poverty line.
 - **Relative Poverty:** Deprivation compared to others in a society.

6.1.1 Measuring Poverty

- **Poverty Line:** A threshold used to define those who are living in poverty.
- **Poverty Measures:**
 - **Headcount Index:** The proportion of people living below the poverty line.
 - **Poverty Gap:** The average difference between the poverty line and the incomes of the poor.

- **Poverty Severity:** Measures the extent of income deprivation among the poor.
- **Multidimensional Poverty Index (MPI):** Measures poverty using multiple dimensions, such as health, education, and living standards.

6.2 Concept of Inequality and its Measurements

- **Inequality:** An uneven distribution of income, wealth, or opportunity in a society.

6.2.1 Measuring Inequality

- **Lorenz Curve:** A graphical representation of income distribution.
- **Gini Coefficient:** A numerical measure of income inequality, ranging from 0 (perfect equality) to 1 (perfect inequality).

6.3 Global and Regional Poverty

- **Global Poverty:** Poverty is widespread in developing countries, with sub-Saharan Africa having the highest rates.
- **Regional Poverty:** Poverty rates vary significantly across regions.

6.4 Women and Poverty

- **Disproportionate Impact:** Women are disproportionately affected by poverty, facing lower income levels, less access to education and healthcare, and limited control over household resources.

6.5 Overview of Poverty and Inequalities in Ethiopia

- **Poverty in Ethiopia:** Ethiopia has made progress in reducing poverty, but it remains a significant challenge, especially in rural areas.
- **Inequality in Ethiopia:** There is a growing gap between the rich and the poor, particularly in urban areas.

6.6 Role of Indigenous Knowledge in Reducing Poverty

- **Indigenous Knowledge:** Traditional practices and knowledge that have been passed down through generations.
- **Examples:** Iqub (rotating savings and credit associations), Idir (mutual assistance groups), Debo (work groups).



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Unit 7: Macroeconomic Reforms in Ethiopia

7.1 National Development Objectives and Strategies - Historical Review

7.1.1 Imperial Period (1950-1974)

- **Focus:** Transitioning to an agro-industrial economy, infrastructure development, import substitution, promotion of commercial agriculture.
- **Key Initiatives:** Five-Year Development Plans.

7.1.2 Socialist Period (1974-1991)

- **Focus:** Centrally planned economy, nationalization of industries, collectivized agriculture, industry-led development.
- **Key Initiatives:** Nationalization of farms, forced villagization, "Zemetcha" (development through cooperation) campaigns.

7.1.3 FDRE (1991-Present)

- **Focus:** Market liberalization, agricultural development-led industrialization (ADLI), poverty reduction, economic growth, structural transformation.
- **Key Initiatives:**
 - Sustainable Development and Poverty Reduction Program (SDPRP)
 - Plan for Accelerated and Sustained Development to End Poverty (PAS-DEP)
 - Growth and Transformation Plans I and II (GTP I and II)
 - Ten-Year Prosperity Plan

7.2 Overview of Home-Grown Economic Reforms in Ethiopia

- **HGER (Home-Grown Economic Reform):** A comprehensive set of reforms aimed at sustaining rapid economic growth, promoting private sector development, and addressing macroeconomic imbalances.

7.2.1 Macroeconomic Reforms

- **Focus:** Stabilizing the economy, reducing debt vulnerability, promoting job creation, and strengthening the financial sector.
- **Key Measures:**
 - Fiscal policy reforms (tax collection, expenditure management, debt management)
 - Monetary policy reforms (interest rate policy, money supply management, financial sector liberalization)
 - Foreign exchange policy reforms (promoting exports, attracting foreign investment, managing foreign exchange reserves)

7.2.2 Sectoral Reforms

- **Focus:** Strengthening priority sectors such as agriculture, mining, tourism, and ICT.

7.2.3 Structural Reforms

- **Focus:** Improving the investment climate, promoting private sector participation, enhancing infrastructure, and developing human capital.

7.3 Fiscal Decentralization

- **Definition:** The transfer of taxing and spending powers from the central government to regional or local governments.

7.3.1 Advantages of Fiscal Decentralization

- **Tailoring Services to Local Needs:** Local governments can better meet the specific needs of their communities.
- **Intergovernmental Competition:** Competition between local governments can lead to greater efficiency.
- **Experimentation and Innovation:** Local governments can experiment with different policies.

7.3.2 Disadvantages of Fiscal Decentralization

- **Interstate/Local Externalities:** Local government actions can have unintended consequences on other jurisdictions.
- **Loss of Economies of Scale:** Decentralization can reduce the potential for cost savings from large-scale projects.
- **Inefficient Tax Systems:** Local governments may not have the same incentives to design efficient tax systems as the central government.
- **Ineffectiveness of Redistribution Programs:** Decentralized programs may attract more poor people to specific regions, straining resources.



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Unit 8: Economy, Environment, and Climate Change

8.1 Economy and the Environment

- **Relationship:** The economy depends on environmental resources, and economic activity can have significant impacts on the environment.

8.1.1 Environmental Resources

- **Types:** Renewable (e.g., forests, solar energy) and non-renewable (e.g., fossil fuels, minerals).

8.1.2 Environmental Degradation

- **Definition:** A decline in the quality of the environment due to human activities.

8.1.3 Population, Resources, and the Environment

- **Population Growth:** Can put pressure on natural resources, leading to environmental degradation.

8.1.4 Rural Development and the Environment

- **Challenges:** Deforestation, soil degradation, water pollution, unsustainable farming practices.

8.1.5 Urban Development and the Environment

- **Challenges:** Pollution, congestion, inadequate water and sanitation, waste management.

8.2 Global Warming and Climate Change

- **Global Warming:** The long-term heating of Earth's climate system observed since the pre-industrial period (between 1850 and 1900) due to human activities that are primarily releasing greenhouse gases.
- **Greenhouse Gases:** Gases in the atmosphere that trap heat, such as carbon dioxide (CO₂), methane (CH₄), and nitrous oxide (N₂O).
- **Climate Change:** Significant and long-term changes in global weather patterns due to global warming.

8.2.1 Causes of Climate Change

- **Greenhouse Gas Emissions:** From burning fossil fuels, deforestation, and industrial processes.

8.2.2 Impacts of Climate Change

- **Global Temperature Rise:** Leading to more frequent and intense heat waves.
- **Changes in Precipitation Patterns:** Increased droughts in some regions and more intense rainfall in others.
- **Sea Level Rise:** Threatening coastal areas.
- **Ocean Acidification:** Harming marine life.
- **Impacts on Agriculture:** Reduced crop yields and changes in growing seasons.
- **Impacts on Health:** Increased spread of diseases and heat-related illnesses.
- **Impacts on Biodiversity:** Loss of species and ecosystems.

8.2.3 Vulnerability to Climate Change

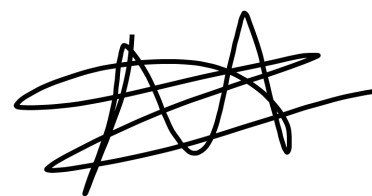
- **Factors:** Exposure to climate hazards, sensitivity to climate change, and adaptive capacity.
- **Most Vulnerable:** Poor and marginalized communities, particularly in developing countries.

8.2.4 Addressing Climate Change Challenges

- **Mitigation:** Reducing greenhouse gas emissions.
- **Adaptation:** Adjusting to the impacts of climate change.

8.2.5 Mitigation Strategies

- **Renewable Energy:** Shifting to energy sources like solar, wind, and hydro.
- **Energy Efficiency:** Using energy more efficiently in homes, businesses, and transportation.



- **Carbon Pricing:** Using carbon taxes, cap-and-trade systems, or emissions trading schemes to make polluters pay for emissions.
- **Forest Conservation:** Protecting existing forests and reforestation.

8.2.6 Adaptation Strategies

- **Water Management:** Improving water conservation and drought-resistant crops.
- **Infrastructure:** Building resilient infrastructure to withstand extreme weather events.
- **Health Systems:** Strengthening public health systems to address climate-related health risks.
- **Early Warning Systems:** Developing systems to warn people about extreme weather events.
- **Migration:** Planning for potential climate-induced migration.

8.3 Green Economy and Green Growth

- **Green Economy:** An economy that aims to achieve sustainable development by promoting environmentally friendly production and consumption.
- **Green Growth:** Economic growth that is environmentally sustainable, reducing carbon emissions and promoting resource efficiency.

8.4 Overview of Environment and Climate Change in Ethiopia

- **Vulnerability:** Ethiopia is highly vulnerable to climate change due to its reliance on rain-fed agriculture, dependence on natural resources, and high poverty rates.

8.4.1 Climate Change Policies and Initiatives

- **National Adaptation Programme of Action (NAPA):** Outlines adaptation strategies for Ethiopia.
- **Nationally Appropriate Mitigation Actions (NAMAs):** Focus on reducing greenhouse gas emissions.

- **Climate Resilient Green Economy (CRGE) Strategy:** Aims to achieve low-carbon and climate-resilient growth.
- **Green Legacy Initiative:** A nationwide tree-planting campaign to combat deforestation.



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