**UNEMPLOYMENT AND PRICE LEVELS (YEAR 1 WORK)**

Please look at RWS 2, RWS 4 and RWS 6 on the Macro side from last year. If you did not have me as a teacher, then please look at the folders on the 1st year GOL page to help with the below. You should also be looking in your textbooks – pp 206-212, 214, 217-219 (ignore Phillips curve analysis for the moment). Also 195 to 203 might help with reminding you of your AD/AS basics.

**UNEMPLOYMENT BASICS**

**Definition of Unemployment**

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| Unemployment can have serious consequences for both individuals and Government’s. Unemployment is defined as those without a job who are actively seeking work. It can be caused by demand (not having enough need for workers) and supply (workers are not willing to work for various reasons) side factors.  The solutions for solving unemployment problems are far from easy. The Government has three approaches: Firstly, it can stimulate demand to create more jobs. Secondly it can intervene in the supply side of the economy to encourage/force potential workers into jobs or the Government can reduce influence and the support it provides in the market to encourage/force potential workers into jobs (e.g. reduce unemployment benefits).  The UK has had to cope with large amounts of structural unemployment as old industries such as ship building and steel making disappeared. More recently the rise of economies such as China and India have meant service industries such as IT based firms, have had to close. |  |

# **Voluntary and Involuntary Unemployment**

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| Unempployment Framework  **16-64**  N.B sometimes classical is called ‘real wage’ and cyclical is called ‘demand deficient’. | **LABOUR FORCE –** the amount of people who are willing to work – sometimes called the workforce or economically active  **EMPLOYED –** members of the workforce who have a job – it could be a part-time or full time job  **UNEMPLOYED –** members of the workforce who have no job but are seeking work. They may be unemployed for a number of reasons – they may be looking for a better job, they may no longer have useful skills, there may not be enough work for them or they are refusing to accept the going wage rate but still want to work.  **ECONOMICALLY INACTIVE –** these are members of society who are considered to be out of the workforce. This may be because they have health issues, they may look after relatives, children, friends etc., they may be students, they may have given up looking for work.  **VOLUNTARY UNEMPLOYED –** these are a group of the unemployed who are considered to be actively choosing not to work because they are refusing to obtain new skills, move to where there are jobs or are not willing to work at the going wage rate etc.  **INVOLUNTARY UNEMPLOYED –** these are the group of unemployed where there lack of a job is out of there control. |

TASK 1: Jack used to be a roofer but more recently he is claiming disability allowance after an accident and is not seeking work currently. Is he considered to be unemployed? Explain why or why not?

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**Recent History and Measurement**

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**TASK:** Circle the ‘Great Depression’, the ‘Second Oil Shock’, the ‘Housing Market Recession’ and the ‘Financial Crash on the graph above (you may need to google these terms to find out when they were).

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|  | **TASK:** Explain the difference in the way the claimant count and LFS measure unemployment. |

**Consequences of Unemployment to the Individual and Economy**

Loss of earnings to the unemployed. Unemployment is the biggest causes of poverty in the UK. Loss of income can leave people without sufficient income to meet housing costs. Rises in unemployment often exacerbate the rates of homelessness. Those who are unemployed will find it more difficult to get work in the future as their skills depreciate and their confidence is low. Employers are less likely to hire someone who has been unemployed for a long period of time; this is called ‘Hysterisis’. Stress and health problems of being unemployed increase significantly. Amongst studies of unemployed men, signs of depression, mental anxiety and health problems are noticeably higher. Unemployment can increase government borrowing and will cause a fall in tax revenue because there are less people paying income tax and also spending less (hence lower VAT). Also the government will have to spend more on unemployment and related benefits. The government doesn’t just pay unemployment benefit, but a family who has unemployment will be more likely to receive housing benefit and income support. One study shows that the cost to the exchequer for one person being unemployed is £6,243 a year in benefits and lost tax revenue. Unemployment can lead to lower GDP for the economy ultimately. High unemployment indicates the economy is operating below full capacity and is inefficient. This will lead to lower output and incomes and therefore might indicate a downturn or recession? Areas of high unemployment (especially youth unemployment) tend to have more crime and vandalism. It can lead to alienation and difficulties in integrating young unemployed people into society.

**TASK:** Read this jumbled paragraph above. Categorise the content into consequences that effect ‘Individuals’ and ‘the Economy’. Each bullet point must be no more than two words. For example the highlighted sentence above affects ‘the economy’ and could be categorised using the words: “Social Problems”.

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| **INDIVIDUAL** | **ECONOMY** |
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**Causes of Unemployment**

**Who is to blame for unemployment? Are workers culpable for their lack of employment?**

TASK: Complete this table using previous notes, relevant excerpts from the textbook

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|  | **Analysis** (Explain this type of unemployment). Unemployment is caused because…. | **Application** (can you provide an example – could by hypothetical) |
| Involuntary | Cyclical or Demand Deficient Unemployment |  |
| Involuntary or Voluntary? | Frictional Unemployment |  |
| Structural Unemployment |  |
| Voluntary | Classical or Real Wage Unemployment |  |

TASK: Complete the following table

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| --- | --- |
| Do you think frictional unemployment is involuntary or voluntary? Explain your answer |  |
| Do you think structural unemployment is involuntary or voluntary? Explain your answer |  |

**Cyclical (Keynes) .v. Real Wage (Classical) Explanations for Unemployment – The GREAT DEBATE!**

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| **Frederick Hayek**  Classical Economist  (Unemployment is Voluntary) | Up until the 1930s, economics had been dominated by “classical economists” like Frederick Hayek who argued that markets were self-regulating, markets would clear and markets were the most efficient method of distributing resources. They claimed that if the economy suffered from a recession in the short run there might be some unemployment (real wage and structural). However in the “long run”, eventually workers would be willing to lower their wages so as not to lose their jobs and so in the long run unemployment would not exist as firms could afford to keep these workers as their costs would fall. In other words, in the long run there would always be ‘Full Employment’.  By the 1930’s, Macroeconomics was not really invented and economists did not really have a toolkit to help explain the workings of the larger economy. This changed in the 1930’s in light of the ‘Great depression’ which seemed to show a persistent level of unemployment that was not reducing as the Classical economists had argued. Workers were losing their jobs and real wages were not falling; it seemed workers would rather lose their jobs than expect a pay cut OR there was simply not enough demand for labour due to the severity of the depression.  John Maynard Keynes, therefore challenged the traditional Classical theory put forward by economists like Frederik Hayek. Keynesian theory, suggested markets weren’t self-regulating, and could be below full employment for a considerable time. Keynes was critical of the UK 1931 budget, which had an ‘austerity feel’ to it as it cut wages for hospital workers, and cut back spending on roads and new houses. He argued this would depress demand further and make the recession worse. Instead he advocated higher government spending financed by higher borrowing.  Keynes’ policy recommendations went against classical orthodoxy. Classical orthodoxy argued higher government spending would crowd out private sector investment. Higher government borrowing would push in interest rates on bonds and reduce the quantity of private sector investment. The Treasury view was to try and balance the budget to have a healthy economy, but Keynes’ criticism was this only reduced overall aggregate demand.  The Great Depression only ended in the UK and US, when government spending on military as a result of World War II boosted demand. Though, there is evidence partial stimulus (e.g. in 1936, helped stimulate demand). After the war, despite Keynes dying, his legacy of spending in a recession and saving in a boom took hold and the UK Government used ‘Keynesian demand management’ until the 1970’s when certain events cast doubt on the effectiveness of Keynes’ approach to reducing unemployment. |
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| **John Maynard Keynes**  Keynesian Economist  (Unemployment is Involuntary) |
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TASK: Explain how Keynes suggested unemployment caused by the Great Depression in the 1930’s be solved?

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**Disequilibrium Unemployment: Microeconomic Analysis**

The diagrams below are ‘micro’ diagrams for the labour markets. Ls represents ‘Labour Supply’ and Ld represents ‘Labour Demand’. Households/Workers supply labour to the market and Firms/Business demand workers. It is the opposite therefore to ‘normal’ supply and demand curves we have looked at in the past where the Households are ‘demanding’ the products and the Firms are ‘supplying the products’.

The diagrams below show the equilibrium wages of the labour market to be at W1 but the actual wage in the market is at W0.

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|  | Explanation of the unemployment position at W0?   * Keynes = * Hayek =   Possible Government solutions to solve the unemployment caused by wages being at W0? Do not forget to signal on the diagram what might happen.   * Keynes = * Hayek = |

**Disequilibrium Unemployment: Macroeconomic Analysis**

The diagrams below represent the entire economy now. Both are in ‘short run’ equilibrium at the blue circle which is essentially ‘disequilibrium’ in the long run. Essentially, we are saying that the economy is not in long term equilibrium until the blue circle is at some point on the LRAS curve.

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|  | Explanation of the unemployment position at the output level of Y2?   * Keynes = * Hayek =   Possible Government solutions to solve the unemployment at output level Y2? Do not forget to signal on the diagram what might happen.   * Keynes = * Hayek = |

**Equilibrium Unemployment: The Natural Rate of Unemployment**

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|  | The diagrams to the right show how classical economists think that there will always be a small percentage of unemployment in the economy. These ‘voluntarily’ unemployed are choosing not to work and so should not be considered a massive issue.   1. What types of unemployment would they consider to be ‘equilibrium types of unemployment'? 2. Why might Keynesians argue against this? |

**PRICE LEVELS BASICS**

**Definition of inflation, deflation and disinflation PLUS hyperinflation and deflationary spirals**

TASK: Provide a definition to the following key terms:

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| --- | --- | --- | --- | --- |
| Inflation | Deflation | Disinflation | Hyperinflation | Deflationary Spirals |
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**Recent History and Measurement**

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|  | **TASK:** What is the RPI and CPI? |  |
|  | **TASK:** Why do you think inflation was low in 2000 and 2015-16? (You may need to Google!)  If the Bank of England was made independent in 1997 and inflation targetting of 2% by the Government was adopted from 1992, what do you think the record of the Bank of England has been? | |

**Consequences of inflation (hyperinflation) and deflation (deflationary spiral) on the individual and economy (goods and bads)**

TASK: Complete this table using your notes, the textbook and any internet sources you can find (tutor2u, economicshelp etc.)

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| --- | --- | --- |
|  | **NEGATIVES** | **POSITIVES** |
| **Inflation** | Individuals | Individuals |
| Economy | Economy |
| **Deflation** | Individuals | Individuals |
| Economy | Economy |

**Causes of inflationary pressures – cost push (commodity prices increase effecting imports) and demand pull (global markets boost exports)**

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| Imagine a scenario where oil prices have risen because of Middle East trouble caused by Donald Trump declaring Jerusalem as the capital of Israel. Draw an AD/AS diagram to help you explain why inflation increases as a result. | Imagine a scenario where countries in the Eurozone, Asia and Middle East have recovered from the financial crash and are starting to grow significantly. Draw an AD/AS diagram to help you explain why inflation increases as a result. |
| Diagram | Diagram |
| Explanation | Explanation |