

**QUESTION ONE: THE AGGREGATE SUPPLY AND DEMAND MODEL**

- (a) Define the term
- unemployment**
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**People who are willing and able to work can start work immediately, but are unable to find a job.**

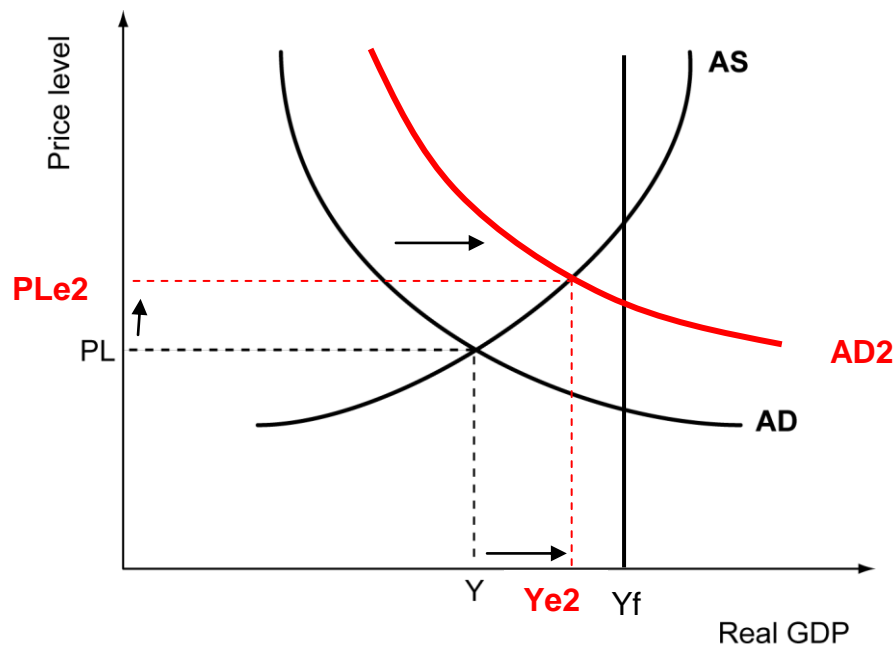
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Personal income tax rates were cut on 1 October 2010.

- (b) On Graph One below, show how a
- reduction**
- in income tax rates would affect unemployment.

**Graph One: AS/AD model of the New Zealand economy**

- (c) Give a
- detailed**
- explanation of the changes you made in (b).

**Define: Aggregate demand is the demand for all goods and services in an economy.**

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**Explain: A decrease in income tax will increase disposable income. An increase in disposable income will lead to an increase in consumption.**

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**Consumption is a component of Aggregate Demand and so Aggregate Demand will increase which will cause an increase in employment.**

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**Relate: Aggregate demand will increase from Ad to AD2. The price level will increase from Ple to PLe2 and output / employment will increase from Y to Ye2, causing a decrease in the recessionary gap.**

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(d) **Compare and contrast** the effects on employment of a reduction in income taxes with an increase in government spending. In your answer, you should:

- explain in detail how a reduction in tax rates would affect employment.
- explain in detail why an increase in government spending may have a **greater** effect on employment than a reduction in income tax rates
- show changes for BOTH events on Graph Two below to support your answer.

**Define: Aggregate demand is the total demand for all goods and services in an economy.**

**Government spending is the buying of goods and services by the government.**

**Explain: An increase in government spending will cause AD to shift to the right because Government spending is a component of AD. So AD will shift to AD3 and employment will increase from Y to Ye3.**

**Government spending may have a greater effect because all of the government spending will go to producers who will then increase production.**

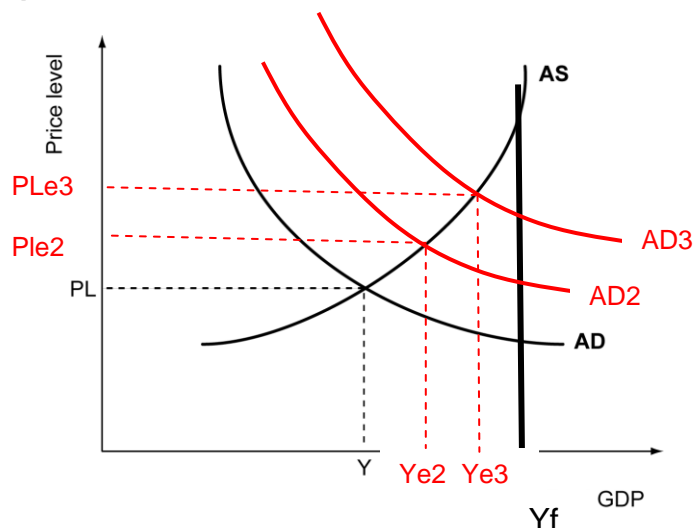
**With the increase in production employment will increase as more workers are now required.**

**Relate: So an increase in government spending will increase AD to AD3 and output to AD3, reducing the recessionary gap by more.**

**A decrease in income tax, will cause an increase in disposable income which may increase consumption which is a component of AD. But consumers may also SAVE some of their increase in disposable income and so AD may not increase by as much as an increase in government spending.**

**So Ad may only increase to AD2 and so employment will increase to AD2, which may be less of an increase than what an increase in Government spending may cause.**

**Graph Two: AS/AD model of the New Zealand economy**



**QUESTION TWO: EMPLOYMENT AND THE PRODUCTION POSSIBILITY CURVE**

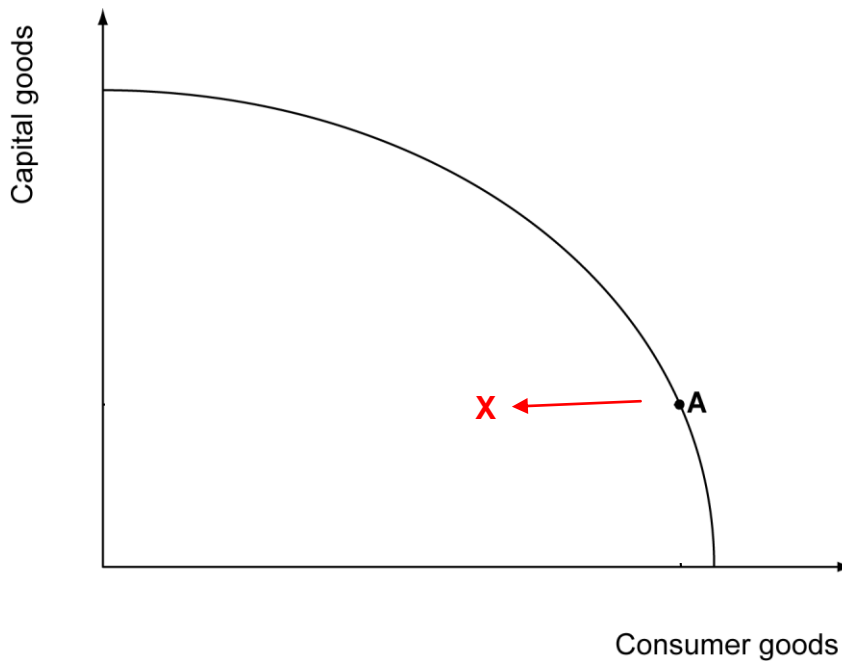
- (a) Describe what a production possibility frontier shows.

**A PPF shows the maximum possible output / production in an economy given a fixed level of resources and technology.**

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- (b) On Graph Three below, show the effect of a **decrease in resource use**. Point A is the current point of the economy.

**Graph Three: Production possibility frontier**



- (c) Give a **detailed** explanation of the change you made in (b).

**A PPF shows the total production possibility for a country given a fixed level of resources and technology.**

**Point A shows a point on the PPF where all resources are being utilised and there is no unemployment.**

**Point B shows a point inside the PPF and not all resources are being utilised and so there is unemployment.**

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(d) **Compare and contrast** the effect of an increase in productivity on employment with an increase in emigration.

- explain in detail how an increase in productivity would affect employment.
- explain in detail how an increase in emigration would affect employment.
- show changes from BOTH events on the PPF model below and integrate these into your answer.

**Define: Productivity is output per worker.**

**A PPF shows the total possible output in an economy given a fixed level of resources and technology.**

**Explain: An increase in productivity will mean that the economy will be able to produce more with the same level of resources because it is using them more efficiently.**

**This will cause an increase of the PPF to PPF2 – a shift to the right of the PPF.**

**This will cause an increase in employment as production and resource use increases.**

**Define: Emigration is people leaving a country.**

**Explain: An increase in emigration will cause the PPF to shift left as there are now less resources ( human resources) in the economy.**

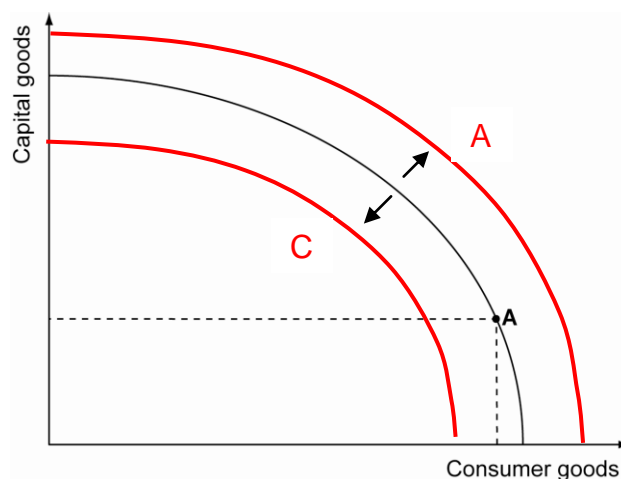
**This will cause a decrease in employment as now less people are available to be employed.**

**With emigration there will be less people and so less consumption leading to a decrease in demand and a decrease in employment.**

**In the short run unemployment may decrease as the unemployed leave the economy or unemployed people fill the jobs of those who have left. In the long run unemployment may increase as there is less people in the economy and so less demand for commodities and so less production.**

**Emigration will cause the PPF for an economy to shift inwards to C, showing the economy is now not able to produce as much due to having fewer resources.**

**Graph Four: Production possibility frontier**



**QUESTION THREE: EFFECTS OF ECONOMIC UNEMPLOYMENT**

- (a) Define Cyclical unemployment.

**Unemployment that occurs during a fall in business activity or recession.**

- (b) The Household Labour Force Survey recorded 200 000 people as being unemployed whereas the number of people on the unemployment benefit is 150 000. Explain the difference.

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**To be unemployed according to the household labour force survey you have to be actively seeking work and be ready to start work immediately.**

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**For the unemployment benefit, some people may be ineligible because they have a partner who is earning an income or their income may be above a threshold. If they are not eligible for the benefit, they will not register and so the number of people on the benefit may be less than HLFS unemployment rate.**

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(c) Compare and contrast the impact of increasing unemployment on i) supermarket businesses and ii) luxury car dealerships. IN your answer you should:

- a detailed explanation of the **impact of increasing unemployment on both firms.**
- a detailed explanation on whether increasing unemployment will have a greater impact on i) or ii)

**An increase in unemployment will cause household disposable incomes to decrease as households receive less income from wages and salaries.**

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**The decrease in disposable income will cause a decrease in consumption.**

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**This will mean that household spending will decrease and so both supermarkets and luxury car dealers will be worse off.**

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**However; the decrease in household income will have a greater impact on the luxury car dealership. Because luxury cars are a luxury and not a necessity, a decrease in income will cause a large decrease in demand for luxury cars.**

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**For the supermarket, the decrease in income will decrease household spending, but because supermarkets sell necessities the decrease in income will have a smaller impact on the supermarket.**

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**Consumers may just change their spending patterns at the supermarket from luxury or higher priced food items to inferior products.**

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**This will mean that although consumer spending may decline at the supermarket, consumers will still have to spend money there and so the supermarket is not as severely affected as the luxury car business.**

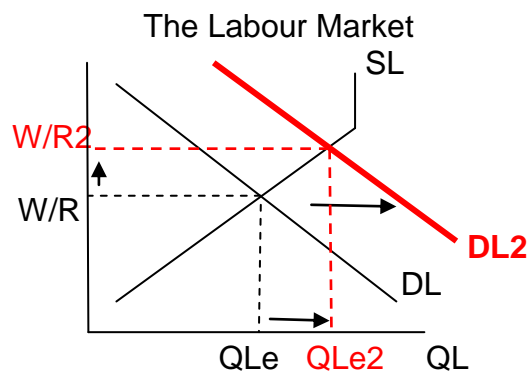
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**QUESTION FOUR: THE LABOUR MARKET**

- (a) Describe the difference between voluntary and involuntary unemployment to explain why full employment of the labour force is unlikely. \_\_\_\_\_

**Voluntary unemployed are people who at the current wage rate are unwilling to work.**

**Involuntary unemployed are people who want a job at the current wage rate and are actively seeking one, but are unable to find one.**



- (b) Show the impact of new technology on labour. Fully label any changes.
- (c) Explain in detail the changes (and reasons for them) that you have made.

**New technology will improve the productivity of labour.**

**The productivity is output per worker.**

**With an increase in productivity, firms make greater profits and increase production.**

**With an increase in production the demand for labour will increase – because labour is a derived demand, an increase in production will cause an increase in demand for labour.**

**So the demand for labour will increase from DL to DL2 causing the employment rate to increase from QLe to QLe2 and the wage rate to increase from W/R to W/R2**

(d) Compare and Contrast the impact on employment between new technology on labour and the impact of new technology that cause demand for new products to increase. **In your answer:**

- explain in detail the impact of new technology on labour.
- explain in detail the impact of new technology that causes the demand for new products to rise.
- explain the impact on employment, involuntary unemployment and voluntary unemployment.
- show the changes to BOTH events on the model and integrate these in your answer.

**New technology can have a negative impact on the demand for labour – with new technology used in production the demand for labour can decrease as firms replace labour with machinery / the new technology. This will shift the demand for labour to the left as shown in D2 below, causing wages and employment to decrease.**

**But new technology can also increase the demand for labour as it will increase productivity and so firms are more willing to employ more people as they make more profit from each unit of input. This will increase the demand for labour shifting the demand curve to the right – increase both wages and the number of people employed. This is shown by D3 in the diagram below.**

**An increase in demand for new products will cause an increase in the demand for labour as labour is a derived demand, an increase in demand for new products will mean new workers may be required to produce more and so the demand curve for labour will shift to the right, causing an increase in both wages and the number of people employed. This is shown by D3 in the diagram below.**

**Both new technology that causes an increase in productivity and an increase in the demand for new products will have a similar effect on the labour market causing employment and wages to increase.**

**But if new technology replaces workers, it will have a negative impact on employment decreasing the demand for labour and shifting the curve to the left. As shown by D2 in the diagram.**

