QUESTION ONE: THE AGGREGATE SUPPLY AND DEMAND MODEL

(a) Define the term **involuntary unemployment**.

**People who are actively seeking work and can start work immediately, but can’t find a job at the current wage rate.**

Government spending decreases.

(b) On Graph One below, show how a decrease in Government spending 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.

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

**Explain:** Government spending is a component of AD, so a decrease in government spending will cause a decrease in AD causing the curve to shift to the left and unemployment to increase.

**Relate:** So AD will shift to the left from AD to AD2, causing employment to decrease from Y to Ye2 and an increase in the recessionary gap.
(d) **Compare and contrast** the effects on employment of a decrease in government spending with a decrease in investment. In your answer, you should:

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

**Aggregate Demand is the demand for all goods and services in an economy in a year.**

**Investment is the buying of capital goods.**

Investment is a component of AD and so a decrease in investment will cause a decrease in AD causing the AD curve to shift to the left. Ad will decrease from AD to AD2 causing a decrease in employment from Y to Ye2.

Government spending is also a component of AD and so a decrease in government spending will also cause a decrease in aggregate demand from AD to AD3, causing employment to decrease from Y to Ye3 and leading to an increase in the recessionary gap.

A decrease in investment will have a larger effect on unemployment because it will lead to a decrease in the buying of capital goods, which means production for capital goods will decrease, this will cause a decrease in the demand for labour and so unemployment will increase.

Also, with a decrease in investment, machinery and factories will become older as they are not being replaced. This will cause a decrease in productivity and so lead to a further decrease in AD to AD2, causing a larger decrease in employment from Y to Ye2, which is larger than just a decrease in government spending.

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**Graph Two: AS/AD model of the New Zealand economy**
QUESTION TWO: EMPLOYMENT AND THE PRODUCTION POSSIBILITY CURVE

(a) Describe what a point inside the production possibility frontier shows.

A point inside the PPF shows unemployed resources or unemployment.

(b) On Graph Three below, show the effect of a recession. 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 X shows a point inside the PPF and not all resources are being utilised and so there is unemployment.
**Compare and contrast** the effect of a fall in productivity on employment with a decrease in unemployment.

- explain in detail the difference between a change in productivity and how it effects employment and a decrease in the unemployment rate.
- show changes from BOTH events on the PPF model below and integrate these into your answer.

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

Productivity is output per unit of input. Productivity is how well an economy is using its resources.

A fall in productivity will mean the economy is not using its resources as efficiently and so the PPF will shift inwards as resources are not used as well.

The PPF will shift inwards from A to B and so the economy will now no longer be able to produce as much as there is a fall in the production possibility for the economy.

With the reduction in production unemployment will increase as producers will not demand as much labour with the fall in productivity and production.

A decrease in the unemployment rate will cause the economy to move to point C, which shows a point where resources are being underutilised

This is a point inside the PPF and so there is unemployment as resources are no longer being fully utilised, but the production potential / possibility remains the same.
QUESTION THREE: EFFECTS OF ECONOMIC UNEMPLOYMENT

(a) Explain the difference between Structural unemployment and Frictional unemployment.

**Structural unemployment is unemployment caused by changes in the economy and the economy is no longer able to match jobs with the skills of workers.**

**Frictional Unemployment is unemployment caused by lags in the labour market / people being between jobs.**

(b) What kind of demand is the demand for labour and what does this mean?

**The demand for labour is a derived demand, which means there is no direct demand for labour, it comes from the demand for other goods and services.**
(c) Compare and contrast the effect of unemployment due to a recession and an increase in unemployment due to a reduction in manufacturing in NZ:

- A detailed explanation of the what type of unemployment each situation is.
- A detailed explanation of which type of unemployment is the most serious.
- A detailed explanation of which type of unemployment may have the most unequal impact and how.

- A reduction in manufacturing is structural unemployment – the labour market is no longer able to match jobs with people’s skills. People who were employed by manufacturing firms will lose their jobs and the skills they have acquired from this job may not be transferable to other areas, they may have to retrain to obtain new skills to enable them to find a job.

- A recession will cause Cyclical unemployment, which will affect different areas across the economy and will affect a number of industries and people. Eventually as the economy recovers these people will find jobs and be re-employed.

- Cyclical unemployment is more serious in the short-run as a lot more people will be affected, but eventually the economy should recover and these people will be re-employed.

- In the long-run structural unemployment may be more serious as the workers will be unable to find a job because their skills no longer match the jobs available in the labour market so even though less people are affected, the situation may continue for a much longer period of time.

- Cyclical unemployment will affect a number of regions and industries and so has a more equal impact across the economy affecting many people.

- Structural unemployment only affects one group of people, in this case people who work at manufacturing firms. The effects of this type of employment will only affect some regions and one industry and so has a more unequal impact than Cyclical unemployment caused by a recession.
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 unemployment is when people do not want a job at the current wage level.
Involuntary unemployment is when people are actively seeking work and can start work immediately, but are unable to find a job at the current wage level.
There will always be a natural rate of unemployment – this is where people are between jobs or do not currently want a job.

(b) Explain in detail the changes (and reasons for them) that you have made.

A minimum wage is set above the equilibrium wage rate. It will cause the quantity demanded for labour to decrease as firms no longer are able / willing to employ as many workers at the higher wage rate. The quantity supplied of labour will increase as more people are willing to work at the higher wage rate. Employment will decrease as firms employ less people. Involuntary unemployment will increase as more people supply themselves to the labour market but there are less jobs available. Voluntary unemployment will decrease.
Compare and Contrast the impact on employment between an increase in the minimum wage on labour and the impact of a decrease in labour productivity. In your answer:
- explain in detail the impact of a minimum wage on labour.
- explain in detail the impact of a decrease in productivity: 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.

An increase in the minimum wage will cause a decrease in the quantity demanded for labour as firms no longer are able/willing to employ as many people at the higher wage rate. The quantity supplied of labour will increase as more people are willing to work at the higher wage rate. As seen in diagram 1 the quantity demanded will fall to QDL2 and the quantity supplied will increase to QSL2. Employment will decrease and involuntary unemployment will increase. The number of people voluntarily unemployed will decrease.

A fall in consumer spending will cause a decrease in demand for goods and services and so AD will decrease, firms will decrease production with the decrease in consumption. This will cause a decrease in demand for labour as firms require less workers as production falls. The demand for labour will decrease causing a shift of the demand curve to the left from DL to DL2.

This will cause a decrease in the number of people employed from QDL2 to QDL3 and an increase in involuntary unemployment. There will be no change in voluntary unemployment, because the minimum wage has not changed no more people are supplying their labour to the labour market.
The Labour Market Diagram 1

The Labour Market Diagram 2