

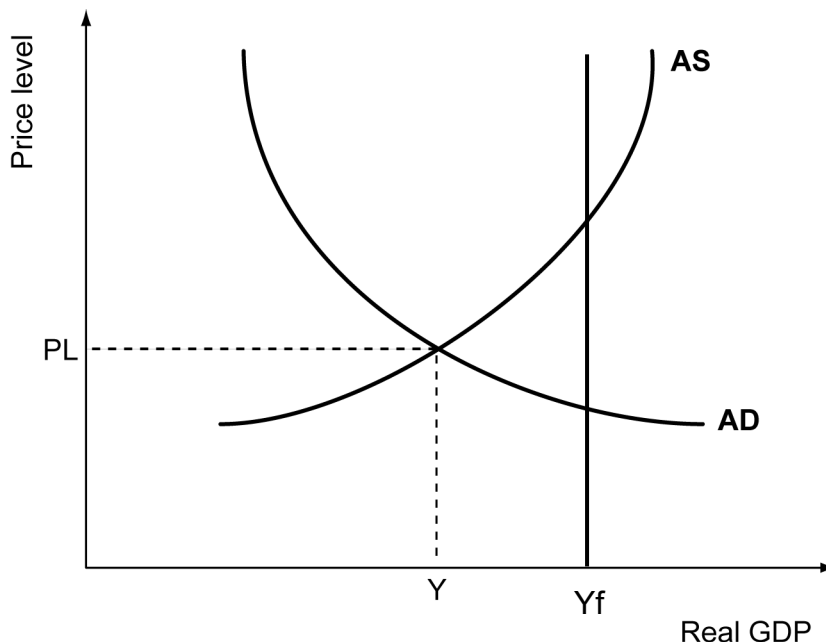
**QUESTION ONE: THE AGGREGATE SUPPLY AND DEMAND MODEL**

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

**People who are willing and able to work, can start work immediately and are actively seeking a job but are unable to find a job at the current wage.**

Consumer spending increases.

- (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: An decrease in government spending will cause an decrease in demand for goods and services.**

**Government spending is a component of Aggregate Demand and so Aggregate Demand will decrease which will cause a decrease in employment.**

**Relate: Aggregate demand will decrease from AD to AD2. The price level will decrease from  $PL_e$  to  $PL_{e2}$  and output / employment will decrease from Y to  $Y_{e2}$ , causing an increase in the recessionary gap.**

(d) **Compare and contrast** the effects on employment of an increase in consumer spending with an increase in investment. In your answer, you should:

- explain in detail how an decrease in government spending would affect employment.
- explain in detail why an decrease in investment may have a **greater** effect on employment than an decrease in government spending.

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.**

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

**Explain: A decrease in investment will cause AD to shift to the left because investment is a component of AD. So AD will shift to AD2 and employment will decrease from Y to Ye2. A decrease in Investment will in the long run also cause AS to decrease, because of new machinery / factories and technology are not being renewed or replaced and so firms efficiency will decrease causing productivity to decrease, meaning AS will decrease. So AS will shift from AS to AS2.**

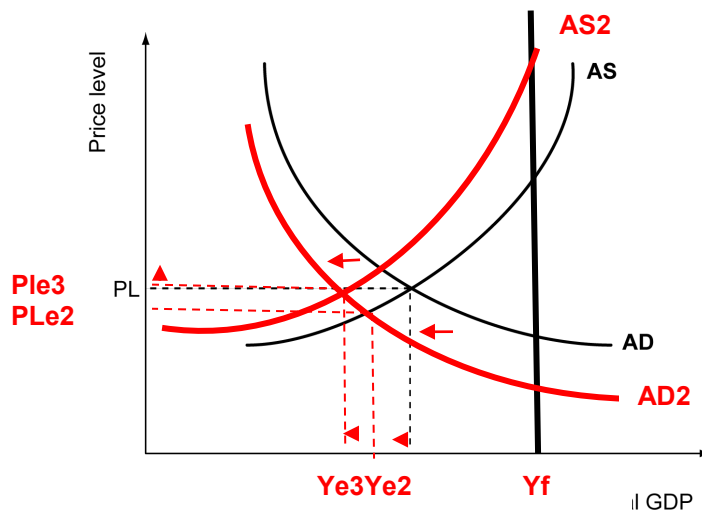
**Investment may have a greater effect because it affects both the AD and AS curves but a decrease in government spending will only affect the AD curve. A decrease in investment will cause an decrease in production.**

**With the decrease in production employment will decrease as less workers are now required.**

**Relate: So a decrease in investment will decrease AD to AD2 and AS to AS2 and output to Ye3, increasing the recessionary gap by more.**

**A decrease in government spending which is a component of AD will cause Ad to decrease from AD to AD2. So AD may only decrease to AD2 and so employment will decrease to Ye2, which is less than a decrease in investment because investment will also cause AS to decrease, causing a larger increase in the recessionary gap and a larger increase in unemployment.**

**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.

**Unemployment / unemployed resources**

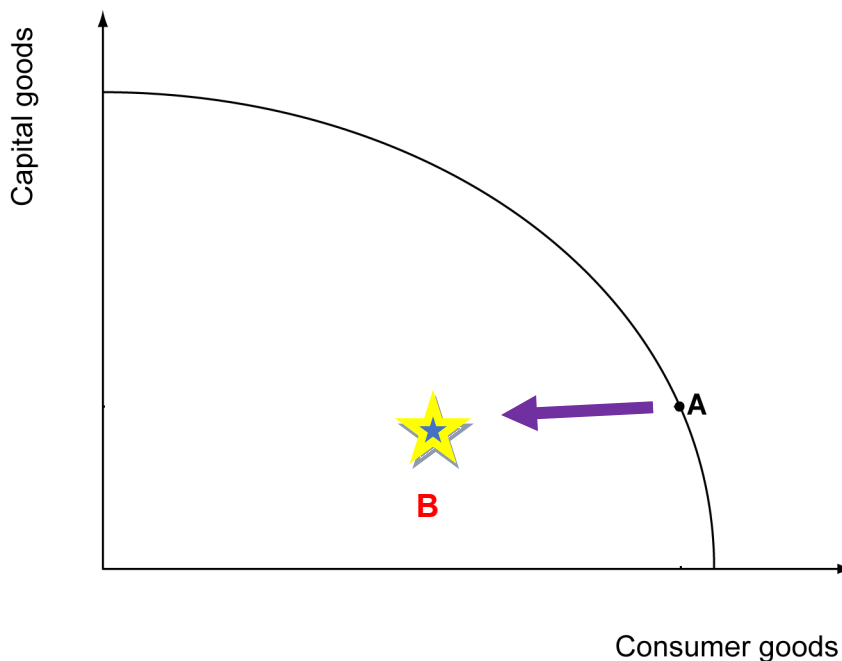
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- (b) On Graph Three below, show the effect of **an increase in unemployment**. Point A is the current point of the economy.

**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 new technology 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 maximum amount an economy can produce given a fixed level of resources and technology.**

**With better productivity the economy is using it's resources more efficiently and so the productive capacity of an economy will increase.**

**This will cause the PPF to shift outwards from A to B and creates a new PPF – this means that the economy is now able to produce more and there has been economic growth.**

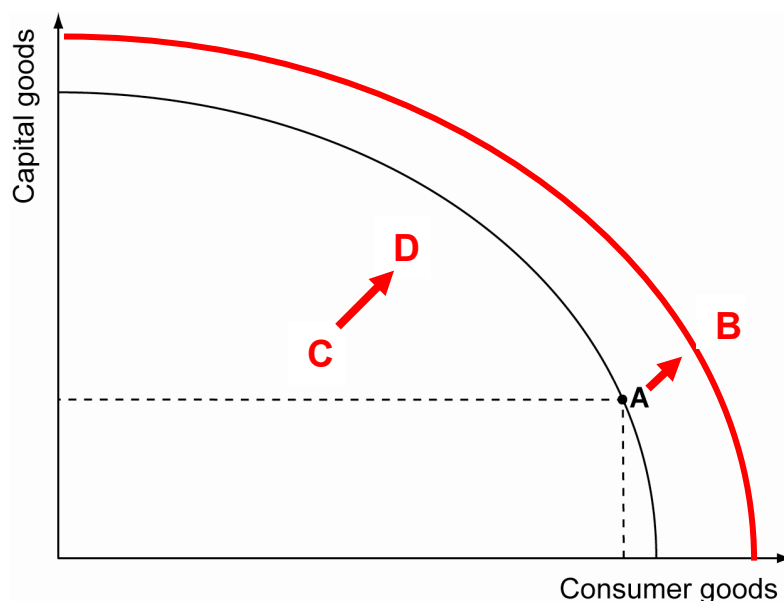
**This will create more employment as output increases and firms need more workers to produce more with the increase in production.**

**Increasing Productivity will also cause an increase in demand for labour as firms are more willing to employ more workers as their increased productivity means their cost per unit of output decreases.**

**So an increase in productivity will create more employment and increase the productive capacity of an economy.**

**A decrease in unemployment is where the economy is moving closer to the PPF and is shown in the diagram where it goes from point C to D. The economy is now using more of its resources and so move closer to full output or capacity. The productive capacity has not changed but the economy is now using more of its resources.**

**Graph Four: Production possibility frontier**



**QUESTION THREE: EFFECTS OF ECONOMIC UNEMPLOYMENT**

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

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**Frictional unemployment is people between jobs. They are usual unemployed for a short time.**

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**Structual unemployment is where the labour market is no longer able to match jobs with people's skills – the industry the people were working in is no longer available and so they may be unemployed for much longer periods of time.**

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

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**The demand for labour is a derived demand. This means that there is no direct demand for labour – it comes from (is derived) from the demand for other goods and services.**

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- (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.
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**Reduction in manufacturing is structural unemployment – the labour market is no longer able to match jobs with people's skills. People who were employed in manufacturing will lose their jobs and the skills they have acquired from these jobs 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 and all regions 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.**

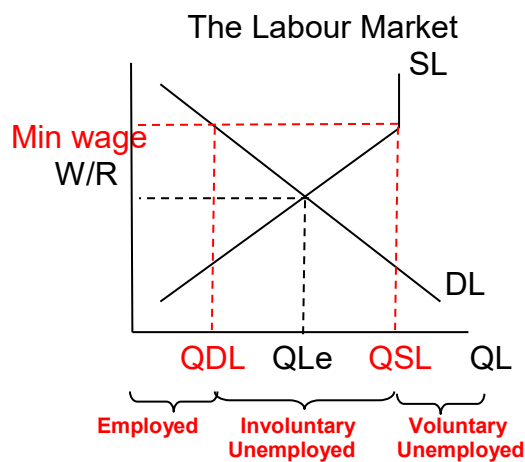
**Structural unemployment only affects one group of people, in this case people who work at sheep processing firms. The effects of this type of employment will only affect some regions and one type of industry and so has a more unequal impact than Cyclical unemployment caused by a recession.**

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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 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) Show the impact of a minimum wage. Fully label any changes.
- (c) 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.

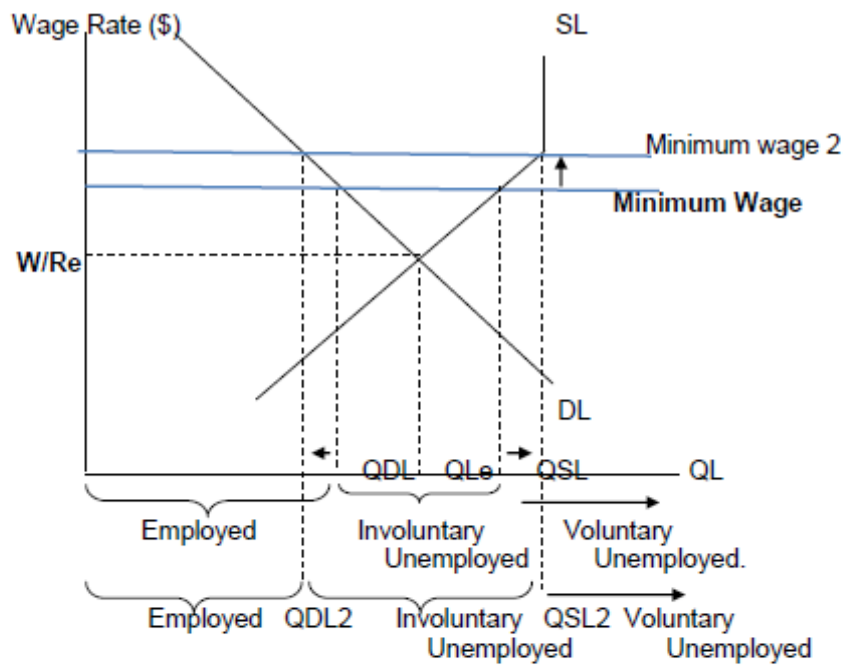
In your answer:

- 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



## d) The Labour Market Diagram 2

