4.3 Unemployment and inflation

Name: _____ Class: _____ Date: _____ **Total: 16 marks**

KEY WORDS unemployment rate • structural unemployment • cyclical unemployment • consumer price index • deflation • natural rate of unemployment

Objective

Build the skills to answer exam questions on **unemployment** and **inflation** : how they are measured, their types, causes and costs, and deflation.

You must be able to:

- calculate the unemployment rate and explain the limits of the figure
- explain structural, frictional, seasonal and cyclical unemployment, and their costs
- explain how a consumer price index (CPI) measures inflation, and the causes and costs of inflation and deflation

1 Key knowledge and worked examples

■ Unemployment and inflation

Unemployment rate $= \dfrac{\text{number unemployed}}{\text{labour force}} \times 100$. The **labour force** is people in work plus those actively looking for work. The rate may hide **underemployment** (part-time workers wanting full-time), **hidden unemployment** (people who gave up looking), and the informal economy.

exercises.lol exercises.com.cn

type	cause	example	policy
structural	skills or location no longer match the jobs	coal miners after mines close	training, relocation help
frictional	short gaps between jobs	a graduate searching	better job information
seasonal	demand changes with the seasons	ski instructors in summer	hard to remove
cyclical (demand-deficient)	low AD in a recession	factory layoffs in 2009	demand-side policies

Costs of unemployment: lost output (inside the PPC), lower tax revenue and higher benefit spending, lost incomes, poverty, skills loss, health problems, crime, social tension.

Inflation is a sustained rise in the general price level, measured by the **consumer price index (CPI)**: the cost of a fixed **basket** of goods, weighted by the share of spending. **Deflation** is a sustained fall. **Disinflation** is a fall in the rate of inflation.

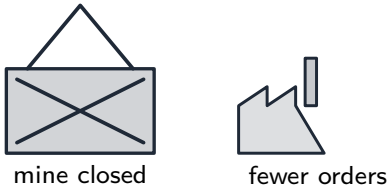
Causes: demand-pull (AD grows faster than capacity) and **cost-push** (SRAS falls: higher wages, oil prices).

Costs of high inflation: loss of purchasing power for those on fixed incomes, uncertainty that cuts investment, less competitive exports, redistribution from savers to borrowers, menu and shoe-leather costs. **Costs of deflation:** consumers delay purchases, real debt burdens rise, firms cut output and jobs: a downward spiral. Many central banks target about 2% inflation.

Answer shapes: identify the type or cause, explain it with the data, and match it to a policy.

2 Practice

2.1 Distinguish between structural and cyclical unemployment. [2]



2.2 In a country, 1.8 million people are unemployed and 28.2 million are employed. Calculate the unemployment rate. [2]

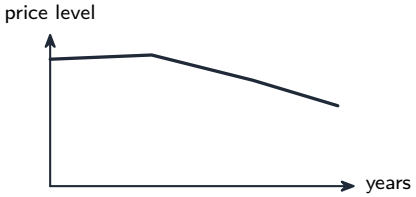


2.3 Explain **two** costs of high inflation for an economy. [4]



3 Exam-style questions

3.1 In one country, prices fell for two years in a row.



(a) Define **deflation**. [2]

(b) Explain why deflation caused by falling demand may harm the economy. [6]

exercises.lol exercises.com.cn